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In the Supreme Court of the United States

OCTOBER TERM, 1979

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of Wisconsin is reported at 90 Wis.2d 700, 281 N.W.2d 94 (1979); the opinion of the Dane County Circuit Court is reported at CCH Wis. Tax Reports, par. 201-373; and the Decision, Findings of Fact and Conclusions of Law of the Wisconsin Tax Appeals Commission is reported at CCH Wis. Tax Reports, par. 201-223. Copies of the foregoing are set forth, respectively, in Appendices A, B and C at pp. App. 1, App. 34 and App. 66.

JURISDICTION

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257(2), this being an appeal which questions the validity of Wis. Stats. §§71.07(1) and (2) on the ground that they are repugnant to the Constitution of the United States, the validity of which was upheld by the Supreme Court of Wisconsin.

The opinion of the Supreme Court of Wisconsin was filed on July 29, 1979. A remittitur order was entered on August 7, 1979, a copy of which is set forth in Appendix D at p. App. 76. No rehearing was had or requested. The Notice of Appeal was filed with the Supreme Court of Wisconsin on September 21, 1979, a copy of which is set forth in Appendix E at p. App. 77.

Jurisdiction of this Court pursuant to 28 U.S.C. §1257(2) is supported by the following decisions:

Hans Rees' Sons v. *North Carolina,* 283 U.S. 123, 51 S.Ct. 385 (1931)

Butler Bros. v. *McColgan,* 315 U.S. 501, 62 S.Ct. 701 (1942)

Moorman Manufacturing Co. v. *Bair,* 437 U.S. 267, 98 S.Ct. 2340 (1978)

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Commerce Clause (Art. I, §8, cl. 3):

> "The Congress shall have power . . . to regulate commerce with foreign Nations and among the several States, and with the Indian Tribes;"

Due Process Clause (Amend. XIV, §1):

> "[N]or shall any State deprive any person of life, liberty, or property, without due process of law;"

The pertinent parts of Wis. Stats. §§71.07(1) and (2) are set forth in Appendices F and G, p. App. 80 and p. App. 80, respectively.

QUESTIONS PRESENTED

1. Whether the State of Wisconsin's assertion that Appellant's total corporate operations constitute a single unitary business for purposes of state taxation, coupled with some alleged nexus between Appellant's operations within the State and some phase of Appellant's total corporate activities, thereby subjecting virtually all of Appellant's corporate income to apportionment, has rendered Wis. Stats. §71.07(2) invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

2. Whether the State of Wisconsin's assessment of income tax on that portion of Appellant's Exploration and Production functional income derived outside the State from extraction of oil and gas not sold to third parties at the well head, and thereby refusing to allocate such income to situs, constitutes a construction of Wis. Stats. §§71.07(1) and (2) which renders the statute invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

3. Whether the State of Wisconsin's assessment of income tax on that portion of Appellant's Exploration and Production functional income derived outside the State from extracton of oil and gas not sold to third parties at the well head, and thereby refusing to allocate such income to situs, constitutes a construction of Wis. Stats. §§71.07(1) and (2) which renders the statute invalid under the Commerce Clause of the United States Constitution.

STATEMENT OF THE CASE

A. Corporate Organizational History.

Exxon Corporation ("Exxon") was formerly named Standard Oil Company (New Jersey) which prior to the name change in late 1972 was the parent of a wholly owned subsidiary corporation named Humble Oil & Refining Company ("Humble"). At about the time of the name change Humble was merged into Exxon, making Exxon the legal successor to Humble, the original taxpayer in this action.

B. Reporting and Audit Pattern.

Appellant timely filed its Wisconsin corporation income and franchise tax returns for the calendar tax years of 1965 through 1968. These returns were prepared and the computation made on the separate state accounting method. Losses were sustained in all four of these calendar years, and no tax was shown as being due for any of these years. On adverse examination the auditor for the Wisconsin Department of Revenue (the "Department") admitted he could not really challenge the separate accounting results.

The field audit for the years in issue concluded that Appellant "is an integrated oil company" and that since Appellant "is a unitary company and its Wisconsin business is an integral part thereof, formula apportionment of the company's income is mandatory and separate accounting is not permissible." As a result it was found that Appellant was "subject to tax on or measured by additional income of $4,532,155" for the period of 1965 through 1968. Additional taxes in the amount of $316,470.85 were thereby assessed.

C. Appellant's Corporate Structure and Corporate Operational Pattern.

Appellant's corporate organization structure during the years at issue consisted of three parts, Corporate Management, Coordination and Services Management and Operations Management. Corporate Management was composed of a board of directors, an executive committee, a chairman of the board who was also the chief executive officer, a president and various directors-in-charge who were members of the board of directors. The Coordination and Services Management consisted of corporate staff departments with the responsibility of providing the overall specialized corporate services that were needed by the corporation.

Operating Management was responsible for directing the operating activities of the individual functional segments of Appellant which consisted of Exploration and Production, Refining, Marketing, Marine, Coal and Shale Oil, Minerals, and Land Management. Each functional segment was organized into a separate department which operated independently of each other operating segment, and was organized in a way so that it could perform essentially on a stand-alone basis. Each operating department was responsible for its own performance both operationally and financially.

The Exploration and Production functional Department was actually composed of three segments, Exploration, Production and Natural Gas. Exploration had the responsibility for the acquisition of reserves of crude oil and gas. Production was responsible for the operation of all of Appellant's producing oil and gas properties including the operation of the natural gas plants and related facilities. Natural Gas was responsible for the purchase and

sale and distribution of natural gas. These three segments were considered part of the Exploration and Production function by the company for accounting purposes.

The Refining Department was responsible for the profitable operation of Appellant's refineries and associated facilities which manufactured petroleum products, special products and petrochemical feed stocks. The Marketing Department was responsible for the profitable distribution and sale of petroleum products through Appellant's marketing facilities.

Each of the functional operating departments had its own separate management responsible for the proper conduct of departmental operations. Each functional department was a separate profit center. In addition, each department was a separate investment center, and records were maintained for each of these departments to reflect the investments in properties and fixed plant. Each operating department had its own corporate accounting office which recorded and reported the cost analysis and the financial results of its operations.

Appellant did not have any crude oil or natural gas production in the State of Wisconsin, nor did it have any refineries located in the State of Wisconsin. Thus, only Appellant's Marketing Department operated in Wisconsin.

The State of Wisconsin was an expansion marketing area where Appellant was making an entry into a new market. Appellant was not widely known in Wisconsin, had limited facilities in the State and, therefore, was required to make additional investments over a long period of time in order to achieve the market position that would make Wisconsin acceptable as a mature market. During the 1960's results of the marketing operations in Wisconsin were very unsatisfactory and resulted only in losses.

D. Utilization of Third-Party Transfer Prices.

It was the policy of Appellant that the transfer prices or values for products and raw materials passing between the three major functional departments, *i.e.*, Exploration and Production, Refining and Marketing, should be based upon competitive wholesale market prices. As there was no mandatory requirement for crude oil produced by Appellant to flow through its own refineries, nor any requirement that its refined products flowing into Marketing must be produced from Appellant's own crude oil production, such crude was either sold to third parties or transferred to a refinery depending upon which method would be the most economical. The refinery was not interested in the ownership of the crude or the source from which it was produced, but, rather, was concerned only with the quality and type of crude oil that was available. Appellant produced crude oil was always transferred from Production to its Supply Department (a non-profit center for the purchase, sale and distribution of crude oil) and then on to the Refining Department or sold to the third parties on the basis of the posted field price for the field in which the crude was produced plus the applicable tariff for transportation.

A posted field price was a published price which indicated what a company was willing to pay for the crude oil it might buy from a particular field. It applied to all purchases of that particular crude, but it was not a commitment to buy; it was only a publication of the price at which crude oil would be purchased if it was in fact purchased. Supply determined what Humble had to pay in order to buy the crude oil it needed. The posted field prices were printed on bulletins by the company which was purchasing the crude oil, and it was a bona fide competitive price. All dispositions of crude oil by Appellant were made at the posted field price, whether the distribution was a transfer to Appellant's refineries by Supply or a sale to third parties by Supply.

The posted field price was the price utilized by Appellant to pay royalty owners under the leases that permitted Appellant to produce the oil. This price was also used by Appellant to pay for oil purchased from any parties having working interests in any particular wells or leases. Whenever Appellant sold crude oil to third parties the posted field price was used as the sales price. Supply, in turn, when it transferred crude to the Refining Department, transferred it at the posted field price. The posted field price was also utilized for purposes of computing depletion for federal income tax purposes, and for computing the severance tax due to the producing states. This price was likewise used by producing states to determine the income allocable to the well head for state income or franchise tax purposes.

None of Appellant's natural gas went to the Refining Department for product conversion. The only gas that went to the Refining Department was used for fuel consumption and amounted to approximately four percent of Appellant's natural gas. All of the gas sold by Appellant was sold in the states where it was produced. Natural Gas did not have any activities in the State of Wisconsin. All gas sold by Appellant to third parties was sold at a negotiated price pursuant to contract negotiations with the purchaser. All gas purchased by Appellant was also purchased pursuant to negotiated contracts. Any internal transfer of gas by Appellant was based upon third-party contracts in effect at the time of the transfer.

Products transferred from Appellant's Refining Department to its Marketing Department were transferred on the basis of wholesale market prices or some equivalent value usually based on prices quoted in Platt's Oilgram. Platt's Oilgram was a price service that primarily reported the wholesale market prices of various petroleum products

at various points in the United States. These were prices of transactions between unrelated buyers and sellers and were prices at which products were actually changing hands in the trade. During the years 1965 through 1968 products transferred between the Refining Department and the Marketing Department were based on a formula tied to the price in Platt's Oilgram with a discount based upon a large third-party sales contract with Standard Oil of Kentucky. If for any day there was a change in the Platt's price for a product there would be a corresponding change in the transfer price between the Refining Department and the Marketing Department. Other products were also transferred at prices equivalent to third party arm's length prices.

The basic objective of Appellant's transfer pricing system was to provide a basis for valuing transfers which would approximate the same results as if one separate independent company had negotiated with another separate independent company.

E. Accounting Practices In The Petroleum Industry And The Use Thereof By Appellant.

In the oil industry the posted field price was a figure at which crude oil was bought and sold in the market at various places. For accounting purposes that price was used as the measure of profitability and the sales value for crude oil. Multifunctional oil companies used posted field prices as a measure of value in transferring crude oil from their exploration and production functions to their refining departments. Without exception, the oil companies used posted field prices in this manner. These companies also used a transfer price on natural gas which was related to existing third-party contracts.

For accounting purposes to correctly and fairly determine the profits of the exploration and production function, the use of posted field prices on transfers between exploration and production and refining gave a result equivalent to a third-party sale price. For transfers between refining functions and marketing functions of multifunctional oil companies, Platt's Oilgram was principally used to determine the transfer prices. Such a use provided an accounting result equivalent to a third-party sale price which was arms length and fair and reasonable for accounting purposes. For internal accounting purposes, the functional operating departments of a multifunctional oil company were generally treated as separate functional segments.

Appellant's internal accounting and transfer pricing procedures isolated and supported the identification of: (1) income derived at the situs of production for the Exploration and Production Department; (2) income derived at the point of operation for the Refining Department; and (3) income derived at the point of operation for the Marketing Department.

From an accounting standpoint, there was no relationship between the income of the Exploration and Production Department and business done by Appellant in the State of Wisconsin. Under generally accepted principles of accounting, such income was fully earned or derived by the Exploration and Production Department at the point where the oil and gas was available for disposition. Under generally accepted principles of accounting, the Refining and Marketing Departments did not serve either to increase or to decrease the amount of Appellant's Exploration and Production functional income.

HOW THE FEDERAL QUESTIONS WERE RAISED AND DECIDED BELOW

Appellant's Petition For Review by the Wisconsin Tax Appeals Commission (the "Commission"), set forth in Appendix H, p. App. 81, contains the following language in paragraph 3(g) at p. App. 84 thereof:

> "As the result of the Department's method of determining Petitioner's net income under the Wisconsin Statutes, income from Petitioner's business, operations and properties outside the State of Wisconsin has been subjected to taxation in Wisconsin, all in violation of the due process clause of the Fourteenth Amendment to the United States Constitution, and which constitute a burden on interstate commerce in violation of Article I, Section 8(3) of the Commerce Clause of the United States Constitution."

After a hearing on the merits, the Commission rendered its decision, see Appendix C, *infra,* p. App. 66, holding in pertinent part that:

1. Appellant's three main functional operations, Exploration and Production, Refining and Marketing, were each separate unitary businesses;

2. The apportionment formula used by the Department in the audit and assessment was improper in including income from Appellant's Exploration and Production and Refining Departments, and resulted in assessing a tax on extraterritorial income earned by Appellant;

3. An apportionment formula, apportioning income earned by Appellant from its Marketing function within and without the State of Wisconsin would be proper and within the mandate of §71.07(2); and

4. Under the Department's assessment the income of Appellant's Exploration and Production and its Refining functions was subjected to multiple taxation.

The Commission's decision was appealed by the Department to the Circuit Court for Dane County, Wisconsin. That Court rendered a Memorandum Decision, see Appendix B, *infra* p. App. 34, finding that Appellant's total corporate business constituted a single unitary business and that its total corporate income was subject to apportionment. But the Circuit Court also found that all of Appellant's income from its Exploration and Production function was situs income that could not be included in apportionable income by the Department, whether the extracted materials were sold to third parties at the well head or transmitted to Appellant's refineries. In addition, the Court found that the taxation of income from Appellant's crude oil and gas produced and not sold to third parties resulted in double taxation of such income. The Due Process and Commerce Clause constitutional issues had been raised in the Circuit Court.

The Circuit Court's decision was brought before the Wisconsin Supreme Court on cross appeals, with Appellant appealing the decision regarding the unitary business holding and the Department appealing the situs income question.

The Wisconsin Supreme Court reversed the Circuit Court's decision on the situs income issue and affirmed on the single, corporate unitary business issue, see Appendix A, *infra,* p. App. 1.

In discussing the unitary business issue, the Court stated that:

> "The purpose of these sections [Sections 71.07(1) and (2)] is to determine what portion of a taxpayer's income is attributable to activities in the state of Wisconsin, since the opening sentence of sec. 71.07(2) states: 'Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state'." (90 Wis.2d at 710, 281 N.W.2d at 100).

The Court continued:

> "Sec. 71.07(2), Stats., (1967) requires that the apportionment method be used by a taxpayer engaged in business within and without the state when the taxpayer's Wisconsin business is an integral part of a unitary business. *Celon Co.* v. *Dept. of Taxation,* 269 Wis. 372, 377-78, 69 N.W.2d 453 (1955). The statute sets forth ratios for the apportionment method but gives the department considerable latitude in adopting a formula which will most accurately reflect a reasonable and equitable tax on the income earned in Wisconsin. *Interstate Finance Corp., supra* at 271-272. [28 Wis.2d 262, 137 N.W.2d 38 (1965)] This court has held that the latitude of the statute itself is not unconstitutional as arbitrary or unreasonable or taxing extraterritorial income, although the application of the statute in some instances might be. *Id.* at 272." (90 Wis.2d at 711-12, 281 N.W.2d at 100-01).

Finally the Court held that:

> "We hold that the taxpayer's Wisconsin operations were an integral part of a unitary business within the meaning of sec. 71.07(2), Stats. (1967). Thus, its income was subject to apportionment under the statutory formula." (90 Wis.2d at 721-22, 281 N.W.2d at 105-06).

In deciding the situs income issue, the Wisconsin Supreme Court stated:

> "The question remains whether the state's effort to reach income from the taxpayer's refining and ex-

ploration and production departments comports with the constitutional requirements of the Due Process and Commerce Clauses.'' (90 Wis.2d at 724, 281 N.W.2d at 107).

The Wisconsin Supreme Court found that the situs income from oil and gas not sold to third parties was part of the unitary stream, and, therefore, was apportionable, and in concluding stated:

> ''The taxpayer's activities have a 'substantial nexus' with the state, as demonstrated by Wisconsin sales of $60,073,293 for the four year period of refined petroleum products and automotive accessories. As discussed above, the tax is fairly apportioned to represent only that part of the taxpayer's income which can be attributed to its Wisconsin activities. There has been no claim that the tax discriminates between interstate and intrastate commerce. Finally, the tax is 'fairly related to services provided by the State.' As the Supreme Court noted in *Japan Line, Ltd.. supra,* at 4480, [..... U.S. ....., 99 S.Ct. 1813, 1820 (1979)] such benefits 'include not only police and fire protection, but the benefits of a trained work force and the advantages of a civilized society.'
>
> ''The fact that the producing states may impose production taxes which are a form of property tax or severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income.'' (footnotes omitted) (90 Wis.2d at 729, 731, 281 N.W.2d at 110-11).

In further support of its position, the Supreme Court of Wisconsin stated ''That Humble reported losses for its Wisconsin operations for the disputed years is immaterial'' (90 Wis.2d at 720 and 281 N.W.2d at 105) and that ''More importantly, the idea of separate functional accounting seems to be incompatible with the 'very essence of formulary apportionment' * * *'' (90 Wis. 2d at 726, 281 N.W.2d at 109). Without having in any way challenged the accuracy or validity of Appellant's separate functional accounting, the Wisconsin Supreme Court thus summarily precluded Appellant from any opportunity of rebutting the taxing consequences which automatically flowed from the unitary *per se* doctrine adopted by the Wisconsin Supreme Court. The Wisconsin Supreme Court attempted to bolster its position by asserting, arithmetically, that the constitutional measure of the State's right to tax is determined by its ''fair share'' of the taxpayer's income rather than by relevance to the activities of the taxpayer in the taxing state:

> ''Using the figures from Exhibit thirty-five, Wisconsin sales for the four years represented .41 percent of total company sales ($60,073,293 divided by $14,-648,694,678). Wisconsin assessed taxable income for the four years represented .22 percent of total company net income adjusted to a Wisconsin basis ($4,532,-155 divided by $2,022,206,871). Wisconsin can hardly be accused or reaching out for more than its fair share of the taxpayer's income.'' (90 Wis.2d at 729, 281 N.W.2d at 110).

From this decision Appellant has appealed to this Court. The decision of the Wisconsin Supreme Court in favor of the validity of the Wisconsin taxing statutes as applied by the Department in the face of Appellant's claims of invalidity, as so applied, under the Due Process and Commerce Clauses in the United States Constitution, raises valid and substantial Federal questions.

THE FEDERAL QUESTIONS ARE SUBSTANTIAL

The Federal questions presented are not only substantial but they are basically issues of first impression, such as to require plenary consideration, with briefs on the merits and oral argument, for their resolution. Appellant *is not* raising such timeworn issues as (1) the right of a state to tax income derived in that state from operations of a multi-state corporation, (2) the right of a state

under appropriate circumstances to employ an appropriate apportionment formula, or (3) the validity of the three factor formula of Wisconsin when properly applied. The new and substantial issues which are raised and challenged in this appeal, elaborated on below, may be summarized as follows: (a) the concept that a total corporate entity is, as a matter of law, unitary *per se,* thereby authorizing the application of an apportionment formula to virtually all the total corporate income based on a minimal nexus to certain corporate activities in the taxing state; (b) the concept that situs income, other than that resulting from out of state, third party sales, becomes a part of the total unitary income and, hence, subject to the application of an apportionment formula; (c) the concept that a state is entitled to tax its "fair share" of total corporate income regardless of its relevance to the activities of that corporation in the taxing state; (d) the concept that multiple taxation as a burden on interstate commerce depends on the fact, rather than on the power, of a situs state to tax; (e) the concept that if a tax is imposed by a situs state with respect to situs operations, no multiple taxation as a burden on interstate commerce results unless the tax of the situs state is of the same type as that imposed by the non-situs, apportioning state; (f) the necessity, resulting from the foregoing concepts of the Supreme Court of Wisconsin, of this Court reversing the law, as pronounced by the Wisconsin Supreme Court, so as to articulate the law of state taxation in a manner consistent with unanimously contrary pronouncements by other state supreme courts and lower Federal courts; and (g) the determination that, by virtue of the foregoing concepts, the application of the apportionment formula under the Wisconsin statute, as approved by the Wisconsin Supreme Court, automatically results in multiple taxation and a burden on interstate commerce. As noted above, all of these new and substantial Federal questions involve either the Due Process Clause or the Interstate Commerce Clause or both.

I. The Wisconsin Supreme Court, By Finding That Appellant's Total Corporate Business Was Unitary, Has Interpreted Wis. Stats. §71.07(2) In A Manner That Violates The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

Section 71.07(2) reads, in part, as follows:

> "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business * * *."

In interpreting this particular statutory provision, the Wisconsin Supreme Court relied primarily on the decisions of this Court in *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123, 51 S. Ct. 385 (1931) and *Butler Brothers* v. *McColgan,* 315 U.S. 501, 62 S.Ct. 701 (1942), two cases producing utterly different factual and taxation results. The Wisconsin Supreme Court, however, asserted that both of these cases stood for the proposition that:

> "* * * the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." (90 Wis. 2d at 718, 281 N.W.2d at 104).

With this somewhat simplified view of the holdings in those two cases, and with the knowledge that Appellant's Marketing Department engaged in activities in Wisconsin, the Wisconsin Supreme Court found, *as a matter of law,* that Appellant was a single corporate unitary business and

that its Wisconsin operations were an integral part thereof within the meaning of Section 71.07(2), and that, therefore, virtually its total corporate income was subject to apportionment under the Wisconsin statutory formula. What the Wisconsin Supreme Court did was to make a determination that Appellant was engaged in the business of manufacturing and selling, and that it was, therefore, unitary *per se* and, hence, subject to having virtually its total corporate income included in the apportionment formula simply because of its very limited marketing activities in Wisconsin.

This unitary *per se* approach is certainly a novel one in state taxation, and does not pass constitutional muster under the Due Process Clause of the Fourteenth Amendment to the United States Constitution when compared to all other decisions of this Court. Only four decisions of this Court have even touched on the "unitary" concept in connection with state taxation, and none of these decisions lend support to the Wisconsin Supreme Court's unique unitary *per se* concept.

In *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271, 45 S.Ct. 82 (1924), this Court was presented with a challenge to the constitutional validity of a New York statute providing for an annual franchise or privilege of doing business tax in New York on foreign corporations. This tax was measured by the net income of the corporation, and the tax was determined by the proportion of the value of certain assets within the state compared to the total value of all such assets located everywhere. This Court found that Bass, Ratcliff was engaged in the unitary business of manufacturing and selling ale, that the practice of manufacturing resulted in no profits until there were sales, and that as such the State Tax Commission was justified in attributing to New York for taxation a just proportion of the profits earned by Bass, Ratcliff from the unitary business. This Court pointed out that it did not believe that the application of New York's statutory taxation method produced an unreasonable result or was inherently arbitrary or an attempt to reach profits earned elsewhere. It was stressed that there was no evidence in the record to determine if Bass, Ratcliff had received any net income from its New York business or the amount of any profit or loss on that business when either considered separately or together with the manufacturing business done in Great Britain. Notably, the controlling factor was the facts, or lack thereof, not any basic "unitary" concept.

In *Hans Rees' Sons* v. *North Carolina, supra,* this Court considered a challenge to the North Carolina income tax as assessed against Hans Rees' pursuant to a single factor (property) apportionment formula. Hans Rees' was a New York corporation engaged in the business of tanning, manufacturing and selling leather. The taxpayer had a manufacturing plant located in North Carolina. Its sales office was located in New York. Sales were made throughout the United States and abroad. Some sales were also made in North Carolina. Hans Rees' established that the income from its business was derived from three sources: (1) buying profit, (2) manufacturing profit, and (3) selling profit. The record also established that for the years in issue, the average income with its source in the manufacturing and tanning operations within North Carolina was 17 percent. The state of North Carolina had, pursuant to its statutory method, for the years in question assessed between 66 and 85 percent of Hans Rees' income to the state. This Court was of the opinion that, when a corporation manufacturers in one state and sells in another, the net profits of the entire transaction, as a unitary business,

could not be attributed, *regardless of the evidence,* to either state. In elaborating on this position this Court stated:

> "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits. The difficulty of making an exact apportionment is apparent, and hence, when the state has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases. But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire income may be taxed in one state regardless of the extent to which it may be derived from the conduct of the enterprise in another state. As was said in the Bass Case with regard to 'the unitary business of manufacturing and selling ale' which began with manufacturing in England and ended in sales in New York, that state 'was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business.' And the principle that was recognized in National Leather Company v. Massachusetts, supra, was that a tax could lawfully be imposed upon a foreign corporation with respect to 'the proportionate part of its total net income which is attributable to the business carried on within the State.' When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a state has applied a method, which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction." (283 U.S. at 133-34).

From the above quote, it is obvious that this Court rejected a unitary *per se* concept, and this concept has not been approved in any subsequent decisions.

In *Butler Brothers* v. *McColgan,* 315 U.S. 501, 62 S.Ct. 704 (1942), the taxpayer contested an assessment under the California Franchise Tax, which is assessed against a corporation's net income as attributed to the state by an apportionment formula. Butler Brothers was an Illinois corporation qualified to do business in California with its home office in Chicago, Illinois, and it was engaged in the wholesale dry goods and general merchandise business, purchasing from manufacturers and selling to retailers. It maintained a wholesale distributing house in California and all receipts from sales in California were credited to the San Francisco house for the period in question by deducting from the gross sales receipts in California, the cost of such merchandise, the direct expenses of the San Francisco house and the indirect expense allocated to it. This resulted in a loss. The California Tax Commissioner, utilizing an apportionment formula consisting of property, wages, and sales, allocated 8.1 percent of Butler Brothers' total corporate net income to California. The taxpayer contended that by use of this formula California had converted a substantial loss into a profit, and that the difference had either been created out of nothing or had been apportioned by California from other states. This Court did not accept Butler Brothers' position. In finding that Butler Brothers was a unitary business, relying primarily on *Hans Rees'* and *Bass, Ratcliff,* and in affirming the tax imposed by California, this Court stated:

> "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 688, 56 S.Ct. 625, 628, 80 L. Ed.

977. This Court held in Hans Rees' Sons, Inc., v. North Carolina, supra, 283 U.S. page 135, 51 S.Ct. page 389, 75 L. Ed. 879, that that burden had been maintained on a showing by the taxpayer that 'in any aspect of the evidence' its income attributable to North Carolina was 'out of all appropriate proportion to the business' transacted by the taxpayer in that State. No such showing has been made here." (315 U.S. at 507).

This Court went on to stress that Butler Brothers had not shown the precise sources of its net income, and had not shown any factors responsible for that income being earned in states other than California. It was also emphasized that no showing had been made that income unconnected with the unitary business had been included in the formula by California.

This Court's most recent opinion regarding state taxation of an interstate business by means of an apportionment formula was rendered in *Moorman Manufacturing Co.* v. *Bair,* 437 U.S. 267, 98 S.Ct. 2340 (1978). Moorman, an Illinois corporation, was engaged in the manufacturing and sale of animal feeds. It sold products to Iowa customers through salesmen and from warehouses in the state. All of the product was manufactured in Illinois. The Iowa apportionment formula is a single-factor formula utilizing sales. Under the Iowa statute the income attributable to Iowa is determined by first eliminating income allocable to other states. From the remaining income, that attributable to business done in Iowa is calculated by taking that proportion of the gross sales made within the state to total gross sales. Moorman challenged the constitutionality of the Iowa single factor formula, and the trial court held the formula invalid under the Due Process and Commerce Clauses of the United States Constitution. The Supreme Court of Iowa reversed, and the case then came

before this Court. This Court, in responding to Moorman's contention that Iowa's single factor formula resulted in the taxation of extraterritorial income in violation of the Due Process Clause, stated:

> "Appellant does not suggest that it has shown that a significant portion of the income attributed to Iowa in fact was generated by its Illinois operations; the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations." (437 U.S. at 272).

Further on in its opinion this Court stated:

> "The Iowa statute afforded appellant an opportunity to demonstrate that the single-factor formula produced an arbitrary result in its case. But this record contains no such showing and therefore the Director's assessment is not subject to challenge under the Due Process Clause." (437 U.S. at 275).

In the above quotes from *Moorman,* this Court has set forth the framework necessary to establish a Due Process violation for a multi-state business challenging a state's apportionment formula. *Moorman* thus acknowledges that separate functional accounting may be used by a taxpayer to identify the income or profits from the various phases or functions of the company's operations and thereby establish that the income attributed to a given state is "out of all appropriate proportion to the business transacted . . . in that state." *Hans Rees' Sons, supra,* 283 U.S. at 135. It should be noted that the Wisconsin Supreme Court rejected this functional accounting approach by stating that it was merely *dicta,* thus ignoring this Court's prescription for finding a Due Process violation. In the record, Moorman made no attempt to establish the profits or income of its manufacturing operation in Illinois, and without such a record this Court could not find that Iowa had taxed extraterritorial income.

In the present case Appellant has done exactly what this Court indicated Moorman should have done in order to establish the taxation of extraterritorial income. By separate functional accounting, Appellant has shown the net income for all three of its functional operations. In Schedule A to Exhibit 28, see Appendix I at p. App. 86, Appellant set forth, for the years in issue, its Wisconsin results on a separate accounting basis, and taxable income and tax for each year if apportionment is used for its Marketing function, and for its Marketing and Refining functions; and its taxable income and tax if its Exploration and Production function is treated as a separate segment or is allocated to situs. This schedule shows that there is a spread of approximately 2.5 million dollars between the income taxable by Wisconsin if Exploration and Production income is allocated to situs and the income the State here attempts to pull in and tax under its apportionment method.

In addition, the testimony of Appellant's witnesses established that Appellant's operational functions were conducted and were accounted for as separate segments of its total enterprise and that the Exploration and Production Department income was all earned outside of Wisconsin from activities outside Wisconsin. The Department offered no contrary evidence. By functional separate accounting, and also by separate accounting for Wisconsin operations, Appellant has proven that extraterritorial income (from Exploration and Production and Refining operations) has been included in the Wisconsin apportionment formula, thereby resulting in a Due Process Clause violation.

Moreover, the fact that Wisconsin's apportionment formula, as applied by the Department, attempts to tax income out of all appropriate proportion to the business transacted by Appellant in the state is conclusively demonstrated by Exhibit 29, set forth in Appendix J at p. App. 87. This shows that Appellant earned a 3.2 percent average return on sales during the years in issue in its company-wide marketing operations, which include both the more profitable so-called mature areas and the less profitable and unprofitable so-called expansion areas. All the testimony and the separate accounting, which the Department's witnesses acknowledged they could not refute, indicated that Wisconsin was in the expansion marketing area classification. Despite this, the Department's assessment attributes to Wisconsin marketing (Appellant's only Wisconsin activity), an average return for the years in issue equal to 7.5 percent of sales, which is approximately 2½ times the company-wide experience including the profitable mature areas for the same period.

What could better demonstrate factually that the Department's assessment is an overreach which attempts to subject to Wisconsin taxation income out of all appropriate proportion to the business transacted by Appellant in the State? Thus, when considered with the unrefuted functional and Wisconsin separate accounting results, Appellant succeeds under this Court's *Moorman* criteria in establishing an unconstitutional overreach. This Court's prescription in *Moorman,* which the Wisconsin Supreme Court chose to ignore, is clearly filled to the requisite standard by Appellant's record in the present case.

Therefore, within the framework established by this Court in *Bass, Hans Rees', Butler Brothers* and *Moorman,* the decision of the Wisconsin Supreme Court and its unitary *per se* concept cannot stand. None of these decisions has reached a finding of unitary *per se.* A finding of unitary at the very most presents merely a condition precedent to the right to apply an apportionment formula to the income of that so-called unitary business, providing that

the taxpayer is unable to show either that all or part of that income is not subject to taxation as not being attributable to business done in the state, or that the resulting tax may be out of all proportion to business conducted in the state. In *Bass, Butler Brothers* and *Moorman* the taxpayer's proof was not sufficient to overcome the condition precedent. However, in *Hans Rees'* it was, and this Court struck down North Carolina's method of taxation as unconstitutional. The opinion of the Wisconsin Supreme Court has even less constitutional validity when the facts in *Bass, Hans Rees', Butler Brothers* and *Moorman* are compared to those in the present case.

Bass, Hans Rees' and *Moorman* involved businesses engaged in manufacturing and selling, and *Butler Brothers* was a business engaged in purchasing and selling. None of these cases concerned a vertically integrated petroleum company operating under the principle of functional profitability independence, as is more specifically described in the State of the Case. Appellant's structure, with its separate internal functional and Wisconsin accounting, makes the unitary *per se* concept expressed by the Wisconsin Supreme Court wholly indefensible under this Court's decisions.

II. The Assessment Of Wisconsin Tax On Income Derived From Appellant's Exploration And Production Functional Operations Outside The State From Extraction Of Oil And Gas Not Sold To Third Parties At The Well Head Constitutes A Construction Of Wis. Stats. §§ 71.07(1) And (2) Which Violates The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

In the trial record Appellant established that, pursuant to its accounting practices and those of the industry, all of the income of its Exploration and Production Department was calculated from third party sales of gas, from actual transfers of crude oil to third parties at posted field prices or from internal transfers between its Exploration and Production Department and its Refining Department based upon the arms length posted field prices utilized in the industry. The record established that the crude oil that went to Appellant's refineries was produced outside Wisconsin and was transferred outside Wisconsin. The total income, therefore, was derived at the situs of the Exploration and Production activities and, under the Wisconsin Statute had to be so allocated, and not apportioned, as all such activities occurred outside of Wisconsin.

This Court held in *National Bellas Hess, Inc.* v. *Department of Revenue,* 386 U.S. 753, 87 S.Ct. 1389 (1967), that a state may not impose a tax unless there is some minimum connection between the activities of the taxpayer in the state and the taxing state. In subjecting virtually all of Appellant's Exploration and Production income to apportionment by Wisconsin, the Wisconsin Supreme Court has ignored this nexus requirement. There are no Exploration and Production activities in Wisconsin, so there can be no connection between such activities and the State. Wisconsin tries to ignore this nexus requirement by making a distinction between situs income as part of the unitary stream and situs income that does not enter a unitary stream. This is clearly an attempt in semantics to make a distinction which is not constitutionally defensible. Situs income, *i.e.,* income having no relationship to the taxing state, cannot be divided up into unitary situs income and non-unitary situs income in order to avoid the constitutional requirement, for purposes of state taxation, of some minimal connection between Appellant's Exploration and Production activities and the State.

The Wisconsin Supreme Court acknowledges that the exploration and production of gas and oil is "mining"

within the meaning of Wis. Stats. §71.07(1), and that such activities are situs operations. The relevant provision of §71.07(1) reads as follows:

> "For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived."

§71.07(2) provides, in pertinent part, as follows:

> "In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient • • •."

By the semantics described above the Wisconsin Supreme Court has also attempted to circumvent the mandate of its own statute, which requires all income "derived" from oil and gas exploration and production to be allocated to situs, thereby eliminating it from apportionable income.

Appellant is aware of no decisions of this Court involving the application of an apportionment formula to situs income earned outside the taxing state. The general prohibition set forth in *Hans Rees'* should be controlling to prevent the taxation of such situs income, as it otherwise results in unreasonably and arbitrarily attributing to Wisconsin "a percentage of income all out of appropriate proportion to business transacted by the appellant in that state." (283 U.S. at 135-36).

It should further be emphasized that separate functional accounting, upon which the identification of Appellant's Exploration and Production situs income is established, was clearly authorized and approved by this Court in *Moorman;* and also that separate accounting for Wisconsin operations is available to corroborate the clear conclusion that extraterritorial income is being taxed by the State of Wisconsin. See Point I *supra,* and particularly Schedule A to Exhibit 28, See Appendix I, *infra,* p. App. 86.

In essence what the Wisconsin Supreme Court has done is to make a distinction between "realized" income, *i.e.,* that resulting from sales to third parties, which it concludes is situs income outside of the unitary stream, and "derived" income, *i.e.,* transferred internally at posted field prices, which it considers to be within the unitary stream despite the fact that the Wisconsin statute, §§71.07 (1) and (2), uses only the term "derived" to apply to both situations. Thus, the Wisconsin Supreme Court has written into the statute a distinction which does not exist in the statutory language.

Certainly no such distinction has ever been made by this Court. Indeed, this Court has never recognized that only "realized" income can be used for determining taxable income. On the contrary this Court has used such words as "attributable to" (*Hans Rees'*), "derived" (*Butler Brothers*) and "earned" (*Moorman*) to describe taxable income. In short, the Wisconsin Supreme Court cannot, upon the pretext of dividing situs income between unitary and non-unitary, attempt to avoid the constitutional prohibitions against taxing income that has no reasonable relationship to the taxing state. A repeat of a quote already set forth in Point I, *supra,* is most appropriate to the present situation.

> "But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived

from the entire business, does not mean that for the purposes of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire net income may be taxed in one state regardless of the extent from which it may derive from the conduct of the enterprise in another state." (*Hans Rees', supra,* 283 U.S. at 133).

By creating two categories of situs income out of Appellant's Exploration and Production income, one being taxable and one not, the Wisconsin Supreme Court has rendered §§71.07(1) and (2) unconstitutional under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

III. The Assessment Of Wisconsin Tax On Income Derived From Appellant's Exploration And Production Functional Operations Outside The State From Extraction Of Oil And Gas Not Sold To Third Parties At The Well Head Constitutes A Construction Of Wis. Stats. §§71.07(1) And (2) Which Violates The Commerce Clause Of Article One Of The United States Constitution.

Since 1920 there has been a series of cases which have held that all oil and gas production income was taxable in the producing states. *Shaffer* v. *Carter,* 252 U.S. 37, 40 S.Ct. 221 (1920); *Magnolia Petroleum Co.* v. *Oklahoma Tax Commission,* 190 Okla. 172, 121 P.2d 1008 (1942); *Texas Company* v. *Cooper,* 236 La. 380, 107 So.2d 676 (1959); *Webb Resources* v. *McCoy,* 194 Kan. 758, 401 P.2d 879 (1965). As reflected by these cases, the jurisdiction where the extraction activity occurs has the power to impose an income tax on Appellant's Exploration and Production income. Where other states such as Wisconsin also impose a tax, this results in multiple taxation of that income and constitutes a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

The Commission found, based upon the testimony of various witnesses, that the taxation of Appellant's Exploration and Production income by Wisconsin resulted in that income being subjected to multiple taxation. See Appendix C, *infra,* p. App. 66. On Appeal the Circuit Court sustained this finding. See Appendix B, *infra* p. App. 34. The Wisconsin Supreme Court neatly sidestepped this finding by observing that the taxes imposed by the situs states were not imposed on income, thus, in its view, eliminating any question as to multiple taxation or a burden on interstate commerce. The precise language is:

> "The fact that the producing states may impose production taxes which are a form of property tax or severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income." (footnotes omitted) (90 Wis.2d at 731, 281 N.W.2d at 110-11)

The compelled inferences from the foregoing are that multiple taxation as a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution occurs only (a) if a situs state having the power to tax situs operations actually exercises that power, and (b) if the situs state does exercise its taxing power, the type of tax imposed must be of the same type as that imposed by the non-situs, apportioning state. This utterly ignores the basic propositions that a violation of the Commerce Clause occurs if a state, Wisconsin in this case, imposes a tax on the situs income derived in another state if that other state has the power to impose a tax on such income, regardless of whether or not that power is exercised, or if the situs state chooses to impose a tax determined by its situs operations of a type or variety other than that being imposed by the other taxing state. Thus, by any test, the

Wisconsin Supreme Court in this case chose to ignore the true strictures of multiple taxation as a burden on interstate commerce. This erroneous conclusion of the Wisconsin Supreme Court is further underscored, both in terms of a violation of the Commerce Clause as well as of the Due Process Clause, by its conclusion that Wisconsin is entitled to tax its "fair share" of the total corporate income of a multi-state corporation regardless of the relevancy of the taxation results to the activities carried on by a multi-state corporation within the State of Wisconsin.

In *Moorman,* the taxpayer also claimed that there was a violation of the Commerce Clause in that both Iowa and Illinois imposed a tax of the income derived from Iowa sales. The taxpayer argued that this was brought about by Iowa's use of the single-factor formula and Illinois' use of the more common three factor formula. This Court did not agree that there had been a Commerce Clause violation, stating:

> "Since appellant did not prove the portion derived from sales to Iowa customers, rather than sales to customers in other States, we do not know whether Illinois and Iowa together imposed a tax on more than 100% of the relevant net income." (437 U.S. at 276).

This Court also stressed that:

> "Since the record does not reveal the sources of appellant's profits, its Commerce Clause claim cannot rest on the premise that profits earned in Illinois were included in its Iowa taxable income and therefore the Iowa formula was at fault for whatever overlap may have existed." (437 U.S. at 277).

In the present record before this Court, Appellant has established that the sources of income derived from its Exploration and Production operations were all in states *other* than Wisconsin. Consequently, the Wisconsin apportionment formula clearly includes income from out-of-state sources by encompassing income from Appellant's Exploration and Production operations, and is therefore in violation of the Commerce Clause of the United States Constitution.

Finally, the Wisconsin Supreme Court, by adopting a unitary *per se* approach which subjects to apportionment virtually all of Appellant's total corporate income without regard to any relationship of the activities of Appellant to Wisconsin, causes multiple taxation as an obvious and automatic end result of such a concept, and thereby places a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

IV. With The Advent Of The Wisconsin Supreme Court's Decision Herein, A Conflict Has Arisen Between Both The Highest Courts Of Various States And With A Federal Circuit Court Of Appeals In The Treatment Of Exploration And Production Income Of An Oil And Gas Company.

The present decision by the Wisconsin Supreme Court to include a portion of Appellant's Exploration and Production income in the Wisconsin apportionment formula, presents a direct conflict with the decisions of five state supreme courts and one federal court of appeals.

The Minnesota Supreme Court in *Skelly Oil Company* v. *Commissioner of Taxation,* 269 Minn. 351, 131 N.W.2d 632 (1964), concluded that the exploration and production, refining and marketing functions of Skelly were operated as separate businesses. Further, it was concluded that because posted field prices were competitively established, were employed for federal depletion, severance tax, production states' income tax and royalty payment purposes, and were utilized as the prices for which the taxpayer bought

and sold crude oil, they constituted a bona fide base for internal transfer pricing from production to refining. Adding this all together, the Minnesota Supreme Court held that only marketing income was exposed to taxation, this being the only function being carried on in Minnesota, and that the unitary concept was inapplicable. The Court concluded that:

> "Skelly's sole activity in Minnesota is the marketing of finished products, as the proof clearly shows. The only permissible conclusion is that taxes based on the inclusion of production income, no matter what the percentage, in apportionable income are beyond the state's authority. Minnesota may include in the apportionable income subject to its tax only income attributable to Skelly's marketing activity." (131 N.W. 2d at 646).

In *Tenneco, Inc.* v. *Barr,* 224 So. 2d 208 (Miss. 1969), the taxpayer operated a gas transmission system, part of which was situated in Mississippi and a gas exploration and production function carried on outside Mississippi. The former was operated at a profit and the latter at a loss, so the taxpayer sought total apportionment on the unitary theory, which the Mississippi Tax Commission opposed. The Mississippi Supreme Court held the transmission business alone to be unitary and subject to apportionment, but that the gas exploration and production operations were not unitary with or an integral part of the transmission operations, and hence, separate accounting applied to those functions.

The Circuit Court of Appeals of the Eighth Circuit, in *Standard Oil Co.* v. *Thoresen,* 29 F.2d 708 (8th Cir. 1928), held that under the law of North Dakota the plaintiff oil company was *not* required to pay North Dakota taxes on its producing and refining oil business done only in other states simply because it engaged in the business of marketing refined products in North Dakota. The Eighth Circuit was of the opinion that any statute of a state which attempted to tax income from property located in another state was void as being beyond the power of the taxing state.

Furthermore, the supreme courts of three states where there was oil and gas production have held that the income from oil and gas production was allocable to situs and taxable in each respective producing state, regardless of whether or not the taxpayer corporation was unitary or whether the income was actually realized or was derived from a fair market value computation. *Magnolia Petroleum Co.* v. *Oklahoma Tax Commission, supra; Texas Company* v. *Cooper, supra; Webb Resources* v. *McCoy, supra.*

Thus, the decision of the Wisconsin Supreme Court is completely contrary to the decisions in *Skelly, Tenneco, Standard Oil, Magnolia, Texas Company* and *Webb Resources*, and this creates the type of split of authority which this Court should resolve.

CONCLUSION

This case presents in specific focus the factual record on the Due Process Clause challenge which this Court found lacking in *Moorman,* as well as in *Butler Bros.* Thus, it presents this Court with the basis to delineate the limits of constitutionally permissible state apportionment of income from a multi-state taxpayer's activities conducted outside the taxing state. The unitary *per se* result of the Wisconsin Supreme Court's decision presents a question of first impression, and the factual record shows taxation of income out of all appropriate proportion to the activities of the Appellant in Wisconsin with a resulting automatic

burden on interstate commerce. And because this decision stands at complete odds with the decisions of other state supreme courts and of lower federal courts, this appeal also presents this Court with the opportunity of resolving this obvious split of authorities.

For the foregoing reasons it is respectfully requested that probable jurisdiction be noted.

Respectfully submitted,

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APPENDIX

APPENDIX A

No. 76-751

STATE OF WISCONSIN : IN SUPREME COURT
WISCONSIN DEPARTMENT OF REVENUE,
Petitioner-Appellant
and Cross-Respondent,

v.

EXXON CORPORATION,
Respondent
and Cross-Appellant.

(Filed June 29, 1979)

Appeal from a judgment of the circuit court for Dane County: GEORGE R. CURRIE, Reserve Circuit Judge. *AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.*

DAY, J. This is an appeal and a cross-appeal in a corporate income and franchise tax case. The judgment from which this appeal is taken was entered in the circuit court for Dane County, January 31, 1977, the Honorable George R. Currie, presiding. The judgment was the result of a proceeding brought by the Department of Revenue, (hereafter Department) under ch. 227, Stats. to review a decision and order of the Wisconsin Tax Appeals Commission, (hereafter Commission) dated April 6, 1976. The Commission had modified the action of the Department denying Exxon's application for abatement of assessment of additional income and franchise taxes for the years 1965 through 1968. During the years in question, the taxpayer was the Humble Oil Refining Company, a wholly owned subsidiary of Standard Oil Company of New Jersey. In 1973, the parent company changed its name to Exxon Corporation, and Humble was merged into Exxon.

The following questions are presented by this appeal:

1. Were the taxpayer's Wisconsin operations an integral part of a unitary business within the meaning of sec. 71.07(2), Stats. (1967)?

2. Does the exclusion from taxation of situs income under the provisions of secs. 71.07(1) and (2), Stats., (1967) apply to all income derived from the production of crude oil and natural gas, or only to that income derived from sales to third parties at or near the well-head?

3. In applying the statutory apportionment formula of sec. 71.07(2), Stats., (1967), did the Department properly weight the cost of manufacturing factor by employing a divisor of 2.6, instead of 3?

We hold that the taxpayer's Wisconsin operations constituted an integral part of a unitary business, subject to statutory apportionment of its income. We also uphold the Department's interpretation of the situs income exclusion to apply only to income derived from sales to third parties at or near the well-head. Finally, for reasons discussed below, we remand the question of the weighting of the apportionment formula to the Commission for further proceedings.

The taxpayer is a corporation organized under the laws of Delaware, with its general offices located in Houston, Texas. This case deals only with the years 1965 through 1968. During that time, Humble Oil and Refining Company was a wholly owned subsidiary of Standard Oil Company of New Jersey. In 1956, Standard Oil of New Jersey organized a wholly owned Delaware subsidiary which then acquired all of the assets and liabilities of Saxon Corporation, a Wisconsin corporation formerly named Pate Oil Company. The new subsidiary continued the operations of the former Wisconsin company, under the name of

Pate Oil Company, which consisted of marketing petroleum products and accessories in Wisconsin. Corporate income tax reporting to the State of Wisconsin was done on the basis of separate accounting which reflected only the Wisconsin marketing operations. In 1960, Standard Oil of New Jersey caused the new Pate Oil Company to be merged into Humble Oil Refining Company, and Humble continued the Wisconsin marketing operations under the brand name of Enco. In 1973, Humble was merged into Standard Oil of New Jersey, and the parent company's name was changed to Exxon. Exxon is the legal successor to Humble.

Humble timely filed its Wisconsin corporation income and franchise tax returns for the calendar tax years 1965 through 1968, using the separate accounting method. The returns showed losses in the amounts of $821,320; $1,159,830; $1,026,224; and $919,575, respectively for the years 1965, 1966, 1967 and 1968. No tax was shown as being due for those years.

The Department audited Humble for the tax years 1965 through 1968, and on June 25, 1971, the Department forwarded to Humble notice of assessment of additional income and franchise tax. The notice was appended to the Department's audit report, in which the auditor stated that Humble's income was subject to apportionment, thus subjecting it to tax on additional income of $4,532,155 for the period 1965 through 1968. Additional taxes in the amount of $316,470.85 were assessed against Humble.

Humble filed an application for abatement of the assessment, which was denied by the Department. Proceedings were held before the Wisconsin Tax Appeals Commission, which modified the Department's action of Humble's application for abatement by a decision and order dated April 8, 1976. The Commission found that Humble's three main

functional operating departments—exploration and production, marketing, and refining—were each unitary businesses. The Commission decided that the Department had properly refused to permit Humble to report its income by the separate accounting method, that for the years in dispute, Humble was operating a multi-state unitary marketing business within the meaning of sec. 71.07(2), Stats., and that Humble's Wisconsin marketing operation was an integral part of that marketing business. However, the Commission also found that Humble's Wisconsin marketing operations were not an integral part of either Humble's exploration and production function or refining function, and that there was no economic dependence between Humble's Wisconsin marketing operations and the exploration and production and refining functions. Thus, the Commission concluded that the Department could not use the statutory apportionment formula to reach income from Humble's refining and exploration and production departments.

On review under ch. 227, the Circuit Court for Dane County set aside some of the findings of the Commission. Judge Currie, in his opinion, stated that the following findings of fact were actually erroneous conclusions of law and set them aside:

> "19. The petitioner's three main functional operating departments, exploration and production, marketing, and refining, were each unitary businesses.
>
> "21. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its exploration and production function.
>
> "23. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its refining function."

The trial court also set aside the following conclusions of law made by the Commission:

> "3. During the years in issue, the petitioner was operating a multistate unitary marketing business within the intent and meaning of Section 71.07(2) of the Wisconsin Statutes, and the petitioner's Wisconsin marketing operation was an integral part thereof.
>
> "6. The apportionment formula used by the respondent in the audit and assessment here under review was improper in including income from petitioner's exploration, production and refining departments, and resulted in assessing a tax on extraterritorial income earned by the petitioner.
>
> "7. An apportionment formula, apportioning income earned by the petitioner from its marketing function within and without the State of Wisconsin, would be proper and within the intent and meaning of the statutory mandate contained in Section 71.07(2) of the Wisconsin Statutes."

However, the trial court also held that the Department's interpretation of the situs exclusions of secs. 71.07(1) and (2) to exclude from taxation only Humble's income from crude oil and gas sold to third persons at the situs of origin, thus subjecting the remainder of situs income to taxation through application of the apportionment formula would be unfair and violative of the intent of sec. 71.07. The trial court also approved the Department's weighting of the costs of manufacturing aspect of the apportionment formula to provide for a divisor of 2.6, instead of 3, as prescribed in the statute.

The Department appeals only from that portion of the judgment which determined that the Department must exclude all situs income derived from the production of crude oil and gas, whether or not sold to third parties. Exxon appeals from those aspects of the judgment which deter-

mined that Humble's total business within and without Wisconsin constituted a unitary business, and which permitted the Department to weight the costs of manufacturing component of the apportionment formula.

QUESTION #1: WERE THE TAXPAYER'S WISCONSIN OPERATIONS AN INTEGRAL PART OF A UNITARY BUSINESS WITHIN THE MEANING OF SEC. 71.07(2), STATS. (1967)?

This case brings into play several sections of ch. 71, Stats., (1967):

"71.01. *Imposition Of Tax; Exempt Income.* . . . (2) *Franchise Tax On Corporations.* For the privilege of exercising its franchise or doing business in this state in a corporate capacity every domestic or foreign corporation, except corporations specified in sub. (3), shall annually pay a franchise tax according to or measured by its entire net income of the preceding income year at the rates set forth in s. 71.09 (2 am). Every corporation organized under the laws of this state shall be deemed to be residing within this state for the purposes of this franchise tax. All provisions of chs. 71 and 73 relating to net income taxation of corporations shall apply to franchise taxes imposed under this subsection, unless the context requires otherwise. The tax imposed by this subjection on national banking associations shall be in lieu of all taxes imposed by this state on national banking associations to the extent it is not permissible to tax such associations under federal law."

"71.07. *Situs Of Income; Allocation And Apportionment.* (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm,

mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived. Corporation income from personal services performed by employes of corporations shall be deemed business income and shall follow the situs of the business. Income from personal services and from professions of resident individuals shall follow residence. Income from personal services of nonresident individuals, including income from professions, shall follow the situs of the services. All other income or loss, including royalties from patents; income or loss derived from land contracts, mortgages, stocks, bonds and securities or from the sale of similar intangible personal property, shall follow the residence of the recipient, except as provided in s. 71.07(7). For the purposes of taxation, interest received on state and federal tax refunds when the tax refunded was on business income or property shall be deemed income from business and shall follow the situs of the business from which derived.

"(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and

> dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios: . . ."

The purpose of these sections is to determine what portion of a taxpayer's income is attributable to activities in the state of Wisconsin, since the opening sentence of sec. 71.07(2) states: "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state."

The two methods—separate accounting and formula apportionment—were described in Keesling and Warren, *The Unitary Concept,* 12 Hastings Law Journal 42, 43 (1960) as follows:

> "In the apportionment of business income two methods have been devised which have come to be known as the 'separate accounting' method and the 'formula' method, respectively. Under the separate accounting method, as the name implies, the business within the state is treated separately and distinctly from the business outside the state and the income is computed in much the same manner as it would be if the taxpayers' activities were confined solely to the taxing state. The gross income from the business activities within the state is first determined. The allowable deductions are then subtracted. The remaining net income is attributed in its entirety to the taxing state.
>
> "Under the formula method the business activities within the state are considered to be an inseparable part of a business carried on both within and without the state. The total gross income from the entire business is determined. The allowable deductions are then subtracted and the remaining net income is apportioned within and without the state by means of an allocation formula consisting of various factors which are thought to be relevant in the production of income, such as property, payroll, and sales."

The term "unitary" has been variously defined. The definition applied in *Interstate Finance Corp.* v. *Dept. of Taxation,* 28 Wis. 2d 262, 269, 137 N.W. 2d 38 (1965), and relied on by the trial court in the instant case, borrows from the text authority Altman & Keesling, *Allocation Of Income In State Taxation,* (2d ed.), p. 101:

> ". . . the essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary."

This is the definition to which we continue to adhere.

Sec. 71.07(2), Stats., (1967) requires that the apportionment method be used by a taxpayer engaged in business within and without the state when the taxpayer's Wisconsin business is an integral part of a unitary business. *Celon Co.* v. *Dept. of Taxation,* 269 Wis. 372, 377-78, 69 N.W. 2d 453 (1955). The statute sets forth ratios for the apportionment method but gives the department considerable latitude in adopting a formula which will most accurately reflect a reasonable and equitable tax on the income earned in Wisconsin. *Interstate Finance Corp., supra* at 271-272. This court has held that the latitude of the statute itself is not unconstitutional as arbitrary or unreasonable or taxing extraterritorial income, although the application of the statute in some instances might be. *Id.* at 272.

The trial court below characterized some of the findings of the Tax Appeals Commission as erroneous conclusions of law, rather than findings of fact. Those findings were: 1) that Humble's three main functional operating departments—exploration and production, marketing, and refining—were each unitary businesses; 2) that there was no economic dependence between Humble's Wisconsin marketing operations and the exploration and production function, and 3) that there was no economic dependence between Humble's marketing operations and the refining function.

Judge Currie, when a Wisconsin Supreme Court Justice wrote the opinion of this Court in *Pabst* v. *Dept. of Taxation*, 19 Wis. 2d 313, 120 N.W. 2d 77 (1963), wherein this Court pointed out that courts use two conflicting methods of administrative review where the issue is whether the administrative agency has correctly applied a statute to certain facts.

> "The first is the so-called analytical approach whereby the court decides which part of the agency's determination presents a question of fact and which part a question of law. The second is the practical or policy approach which tries to avoid allocation of functions merely on the literal meaning of the terms 'fact' and 'law.' When this practical approach is used, the court holds that, 'The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body.' On the other hand, Davis notes that when the court deems the question presented to be suitable for judicial determination, it feels free to substitute its own judgment for that of the agency. When the court substitutes its own judgment, however, it would appear that it in effect finds the agency's decision without rational basis in law or treats the issue analytically as a question of law for the court." *Id.* at 322-23.

While this court has held that ch. 227, Stats. requires that courts employ the "analytical" approach when reviewing agency decisions, this court will give deference to agency determinations, where the agency has particular expertise, rational basis exists in law for the agency's interpretation, and it does not conflict with the statute's legislative history, prior decisions of this court, or constitutional prohibitions. *Id.* at 323-24.

When mixed questions of law and fact are presented to this court, there are really two component questions which must be answered. The first question is what, in fact, actually happened; the second question is whether those facts, as a matter of law, have meaning as a particular legal concept. Comment, *The Scope Of Judicial Review Of Administrative Agency Decisions In Wisconsin*, 1973 Wis. L. Rev. 554 (1973). The question of whether the facts fulfill a particular legal standard is itself a question of law. See *Cheese* v. *Industrial Comm.*, 21 Wis. 2d 8, 15, 123 N.W. 2d 553 (1963).

Thus, for example, in *Cheese, supra,* the court substituted its judgment for that of the Industrial Commission on whether particular conduct by the claimant constituted "misconduct connected with his employment." In *Pabst, supra,* the court concluded that the question of whether a trust was administered in Wisconsin was a question of law. In *Globe-Union, Inc.* v. *Dept. of Taxation,* 20 Wis. 2d 213, 219, 121 N.W. 2d 894 (1963), the court treated as a question of law, whether various sales had been made in Wisconsin for purposes of corporate income tax apportionment.

This court accepts the view of the circuit court in this case that the question of whether Humble constituted a unitary operation is a question of law. The manner in which Humble conducted its business requires a series of fac-

tual determinations; the legal significance of those business arrangements is a judicial question subject to review by this court. Further, in its findings, the Tax Appeals Commission only stated that there was no economic dependence between the Wisconsin marketing operations and the refining and exploration and production functions of Humble. The full test requires a determination of whether the operation of the portion of the business is "dependent upon *or contributory to* the operation of the business outside the state." *Interstate Finance Corp., supra,* 28 Wis. 2d at 269. (emphasis added).

For the years in question, Humble's corporate organization consisted of three parts: corporate management, coordination and services management, and operations management. Corporation management was the highest level of management in the company. In this review, the court is concerned only with operations management which was responsible for directing the operating activities of the individual functional segments of the company. Each functional segment was organized into a separate department which operated independently of the other operating segments. The individual functional segments under Operations Management consisted of Exploration and Production, Refining, Marketing, Marine, Coal and Shale Oil, Minerals, Land Management. Exploration and Production was further broken down into exploration, production, and natural gas. The three major departments were Exploration and Production, Refining, and Marketing.

Each operating department had its own separate management responsible for the proper conduct of the operation. Each had a separate profit center which provided a means for recording transactions involving expense and revenue so that a profit for each function could be determined. Each department was considered a separate investment center by the company.

It was the management philosophy of Humble to have each department independently responsible for its performance in order to measure the performance of each department. Under this system, each department is in competition with the other departments for available funds for investment. Each functional department was also in competition with other members of the industry operating the same function.

There was no requirement that crude oil produced by the Production department flow through the marketing outlets in the form of Humble refined products. The company had extensive dealings with third parties for the acquisition of raw materials and products sold.

It was company policy that the transfer of products and raw materials between departments be based on competitive wholesale market prices. Thus, crude oil produced and transferred to the refining department was accounted for at posted industry prices. As a result the refining department paid the same price for Humble-produced crude as it would pay for crude oil from any other supplier. Products transferred from the refining department to the marketing department were also based on wholesale market prices or some alternate value. Where there was no readily available wholesale market value for a product, Oral Luper, an Exxon senior vice president testified that "the representatives of our Marketing Department and our Refinery Department with both of their knowledge of the market, knowledge of the products, negotiate with each other on an arm's length basis in an adversary position to try to negotiate the appropriate transfer value to the best of their ability, market orientated."

Significantly, Luper also testified as to the reasons for organizing the separate operating departments under one corporate entity.

> ". . . [I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> "So, in the case of the petroleum industry . . . where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important and therefore when there are—when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time."

Luper also stated that putting the individual operating segments under one corporate entity provided greater profit stability for the company, spread risks, and enabled corporate staff to provide services on a corporate-wide basis more efficiently and effectively. The existence of a stable and assured market outlet is directly related to the refining investment. Luper testified that as an officer of the company, he is concerned directly with the overall profits of the entire company. The profits of each of the individual functional segments go into a determination of the overall corporate profits.

Humble has a uniform credit card system used nationwide which is a valuable marketing tool. It is administered centrally in Houston, Texas, with accounting and collection carried out at two or three credit card centers. Humble promotes its products by uniform packaging and brand

names. The overall plan for distribution of products is developed in Houston. Promotional display equipment is designed by the engineering staff at headquarters marketing. Key employees of the Company are transferred from one department to another frequently.

The factors determining whether Humble produced crude oil will be sold to third parties or transferred to the Humble refinery include the distance from the point of production to the refinery and the quality of the crude. Once Humble-produced crude enters the pipeline system, it moves to the most desirable market, and in some cases, that is to a Humble refinery. There is no way of identifying the origin of the crude oil after it has entered the pipeline.

It is undisputed that Humble carried on no production or refining functions in Wisconsin. The only activities in the state related to marketing of the product. The gasoline and fuel oil sold in Wisconsin by Humble did not originate in Humble's oil wells. They came into the state as a result of an exchange agreement Humble had with Pure Oil Company at Lemont, Illinois. The products exchange portion of the agreement was set up at a time when Humble was expanding in the Midwest market. Pure Oil had more refining capacity than marketing requirements in the Midwest and wanted to find a way to get products to the East coast. The major purpose of any exchange agreement of this type is to reduce the cost of transporting the product from the source of production to the point where it is sold. The exchange contracted was negotiated by Humble's Supply and Refining Departments.

The gasoline received by Humble in the exchange is either refined according to Humble's specifications or meets certain basic criteria before it is accepted by Humble for exchange. For Humble-refined gasoline, additives

developed by Humble are mixed into the gasoline at the refinery. For gasoline acquired through exchange, the Humble additives are injected into the gasoline at the point of exchange. Seasonal variations in weather must be taken into account so that a different gasoline is manufactured for winter than is manufactured for summer. Quality control starts at the time of refining and continues through transportation to insure that the quality of gasoline delivered at the service station is the same as that produced at the refinery.

Motor oils, greases, and other packaged products were produced and manufactured by Humble outside of Wisconsin and shipped into the state for sale from Humble's central warehouse facilities in Chicago, Illinois, and other out-of-state locations. Tires, batteries and accessories were centrally purchased by Humble's purchasing office in Houston, Texas and shipped from out-of-state locations into Wisconsin for sale.

What emerges from this pattern of organization is that Humble's production and refining functions depended upon the marketing operation to provide an outlet for its products. Wisconsin was a part of Humble's marketing system. In a high capital investment industry such as the petroleum industry, the existence of a stable and assured marketing system is important for the full utilization of refining capacity. This was the testimony of a top Exxon executive who admitted that the profits of the overall corporation depend on the profits of each of the individual functional segments.

The United States Supreme Court has held that the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the

realization of profits. *Butler Brothers* v. *McColgan*, 315 U.S. 501, 508 (1942); *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 133 (1931).

The Oregon Tax Court, in a case dealing with the identical taxpayer, faced a factual pattern virtually indistinguishable from the one before this court. Humble's operations in Oregon were almost exclusively concerned with marketing. It had no manufacturing or refining facilities in Oregon, nor any sale of crude oil or natural gas. Although it was engaged in exploration for crude oil in Oregon during the years in question, there was no production. All of the refined petroleum products and related automotive accessories sold in Humble's service stations in Oregon were acquired by purchase from third party suppliers, except for oils and greases which were supplied centrally by Humble from its plants and refineries throughout the United States. These centrally supplied items amounted to about five percent in value of the total products marketed in Oregon. Humble's books, maintained on a separate accounting basis, showed a net operating loss for the Oregon operations.

The Oregon Tax Court determined that Humble was a unitary business and that the apportionment method of accounting was proper because it most fairly and accurately reflected the net income of the taxpayer attributable to Oregon. The court also made the following comments:

> "Humble Oil & Refining Company is a large vertically integrated corporation engaged nationwide in all phases of the petroleum industry, from discovery through production and manufacture to marketing. It has unity of ownership, operations, management, control and products; and strong centralized credit, purchasing, advertising, accounting and legal services. All segments of plaintiff's business have a great deal in common and contribute to and are dependent upon

each other. The plaintiff is actually a single interrelated unitary business operation. The component parts, including those in Oregon, are too closely connected and necessary to each other to be considered as independent units.

"Producing in one state and selling in another depends upon a multitude of interdependent operations, and although the petroleum Humble sold in Oregon was not its own production but that of a third party, the sales nevertheless were made possible by the company's own production. If plaintiff wasn't producing it wouldn't be selling, and what plaintiff did in Oregon was not due solely to conditions here, but was dependent upon the market elsewhere and upon plaintiff's production and manufacturing elsewhere. The marketing in Oregon was an integrated part of plaintiff's nationwide business and undoubtedly was beneficial to the corporation as a whole. It was not a completely separate, independent or local endeavor. Plaintiff's production and refining conform to the demands of the nationwide market, and the court believes plaintiff expanded into Oregon to increase demand for its products so that it could increase production and refining and thus increase profits and its stature in the industry.

There certainly was more to plaintiff's decision to operate service stations in Oregon than the mere hope the stations might show a profit. The purpose of marketing here was to increase over-all marketing strength for the benefit of all phases of plaintiff's business. Costs incurred here led to profits elsewhere, and the primary measure of success of Oregon activities was not the profit or loss shown on the income statements of the local service stations, but rather it was the contribution the stations made to plaintiff's over-all operations and growth that really counted. The plaintiff bought its Oregon inventory of gasoline from third parties because it was more economical to do so, and whether an outlet sold Humble production or that of

another company was a central management decision based on over-all economic considerations. Each activity of the company was carried on in whatever locality was most economically feasible. Plaintiff was so organized and vertically integrated that its separate parts, geographical and structural, could not be fairly considered by themselves." *Humble Oil & Refining Company* v. *Dept. of Revenue,* 4 OTR 284, 292-93 (1971).

That Humble reported losses for its Wisconsin operations for the disputed years is immaterial. The same question was addressed in *Butler Brothers* v. *McColgan, supra.* In that case, Butler Brothers was a wholesale merchandising company whose home office was in Illinois, and which had branches in seven different states. It attempted to show that its California branch operated at a $70,000 loss as reflected in a separate accounting return, and that an income tax calculated on an apportionment basis was unconstitutional because it taxed extraterritorial values. The Supreme Court commented:

"It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113, 121, that a State in at-

tempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' Furthermore, the particular system used may not reveal the facts basic to the State's determination. *Bass, Ratcliff & Gretton, Ltd.* v. *Tax Commission, supra,* p. 283. In either aspect of the matter, the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here." 315 U.S. at 507-508.

We hold that the taxpayer's Wisconsin operations were an integral part of a unitary business within the meaning of sec. 71.07(2), Stats., (1967). Thus, its income was subject to apportionment under the statutory formula. The constitutionality of this apportionment will be discussed below together with our consideration of the situs income exclusion.

QUESTION #2: DOES THE EXCLUSION FROM TAXATION OF SITUS INCOME UNDER THE PROVISIONS OF SEC. 71.07(1) AND (2), STATS., (1967), APPLY TO ALL INCOME DERIVED FROM THE PRODUCTION OF CRUDE OIL AND NATURAL GAS, OR ONLY TO THAT INCOME DERIVED FROM SALES TO THIRD PARTIES AT OR NEAR THE WELL-HEAD?

The pertinent portions of sec. 71.07 are:

"71.07. *Situs Of Income; Allocation And Apportionment.* (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property

or tangible personal property shall follow the situs of the property from which derived. . . .

"(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; . . ."

The parties agree that extraction and production of gas and oil is "mining" within the meaning of sec. 71.07(1), Stats., *supra.* Gas and oil operations were held to be situs operations by the Tax Appeals Commission in *Leonard R. Jevne* v. *Dept. of Revenue,* Docket No. I-4956, April 14, 1976 CCH par. 12-402.577; *Deane A. Neitzel* v. *Wisconsin Dept. of Revenue,* Docket No. I-4872, November 17, 1975, CCH par. 12-402.577 and we concur in that view.

It is the position of the Department of Revenue that the situs income exclusion applies only to income realized from sales of crude oil and gas to third parties. The Department does not recognize as excludable situs income the value of crude oil and gas transferred by Humble from its production to refinery operations. There was testimony that such transfers took place at "posted field prices," which are considered to be bona fide third party prices.

Sec. 71.07, Stats. (1967) divides the income of a taxpayer operating both within and without Wisconsin into "apportionable income" and "nonapportionable income." Apportionable income is that income which for income tax purposes must be allocated to two or more states in which the taxpayer's business is carried on. Non-apportionable income is that income which follows the situs of the property or the residence of the taxpayer and, as a result, is not allocated among two or more states. *Transamerica Financial Corp.* v. *Dept, of Revenue,* 56 Wis. 2d 57, 65-66, 201 N.W. 2d 552 (1972).

However, the statute contains an ambiguity since sec. 71.07(1), reads:

> ". . . For the purpose of taxation income or loss from business, *not requiring apportionment* under sub. (2), (3) or (5), shall follow the situs of the business from which derived. . . ." (Emphasis added).

Since Exxon is unitary, apportionment of its business income *is* required. This reading of the statute supports the department's interpretation that situs income which is part of the unitary stream of income is apportionable, while situs income which does not enter the unitary stream is nonapportionable, and therefore excludable. If situs income could not be apportioned, there would have been no reason to include the words "not requiring apportionment. . . ." in the subsection dealing with situs income.

The holding of *Transamerica Financial Corp., supra,* which construed the meaning of the interest and dividends deduction of sec. 71.07 is inapposite. There, the court said an administrative construction by the department would not be given force where inconsistent with an unambiguous statutory provision. Here the statute is ambiguous, and subject to interpretation.

The question remains whether the state's effort to reach income from the taxpayer's refining and exploration and

production departments comports with the constitutional requirements of the Due Process and Commerce Clauses.

If a state tax " 'is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State,' no impermissible burden on interstate commerce will be found, *Complete Auto Transit Inc.* v. *Brady,* 430 U.S. 274, 279 (1977); *Washington Revenue Dept.,* 435 U.S. at 750." *Japan Line, Ltd.* v. *County of Los Angeles,* ..... U.S. ..... [47 U.S.L.W. 4477 (April 30, 1979)].

Recently, the United States Supreme Court upheld the constitutionality of Iowa's single factor apportionment formula. *Moorman Mfg. Co.* v. *Bair,* 437 U.S. 267 (1978). In that case, Moorman Manufacturing was an Illinois corporation engaged in the manufacture and sale of animal feeds. The products sold to Iowa customers were manufactured in Illinois, but the company had over 500 salesmen in Iowa and owned six warehouses in the state from which deliveries were made to Iowa customers.

Moorman's Due Process argument rested on two premises—first, that its Illinois operations were responsible for some of the profits generated by sales in Iowa, and second, that a formula that reaches any income not in fact earned within the borders of the taxing state violates due process.

On the first argument, the Court said that Moorman had failed to make out a factual case:

> "Appellant does not suggest that it has shown that a significant portion of the income attributed to Iowa in fact was generated by its Illinois operations; the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of

the company's operations. But appellant contends that we should proceed on the assumption that at least some portion of the income from Iowa sales was generated by Illinois activities." 437 U.S. at 272.

Exxon maintains that this language entitles it to succeed since by separate functional accounting, it has shown the income for all three of its functional operations. In Exhibit twenty-eight, Humble set forth a comparison between the Wisconsin results yielded by separate accounting, and those yielded by apportionment of the marketing function alone, the marketing and refining functions, as well as alternative treatment of situs income from the exploration and production department.[1] Exxon argues that it has proven by functional accounting that extraterritorial income was included in the Wisconsin apportionment formula, since Humble's exploration and production income was all earned from activities outside of Wisconsin.

Initially, we point out that the implication in the language upon which Exxon relies is merely *dicta*. More importantly, the idea of separate functional accounting seems to be incompatible with the

> "very essence of formulary apportionment, namely, that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps. It is for that reason that the States have resorted to formulary apportionment—unrefined and approximate though the results may be—in the case of an enterprise engaged in manufacturing and selling, where the activities take place in more than one State. Essentially, the same inherent difficulties are present in seeking to divide the profits of an oil company, where producing, manufacturing and marketing take place in different States." Hellerstein, *State And Local Taxation*, (3rd Edition, 1969), p. 400.

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[1] Footnote 1 on following page.

[1] Abstracted from Exhibit 28:

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Summary of Alternative Methods of Attributing Income to Wisconsin

Schedule A -- 1965-1968
Page 1 Of 1

Year	State's Hybrid Apportionment		Humble's Wisconsin Separate Accounting		Marketing Function Apportioned Only		Marketing & Refining Apportioned Only		Exploration And Production Separate Business or Allocation to Situs	
	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax
1965	$ 759,371	$ 52,961	($ 821,320)	$ -0-	$ 541,794	$ 37,731	$ 282,383	$ 19,572	$ 310,841	$ 21,564
1966	1,043,395	72,843	(1,159,830)	-0-	316,081	21,931	430,866	29,967	443,520	30,851
1967	1,264,946	88,351	(1,026,224)	-0-	394,993	27,455	490,252	34,123	503,182	35,028
1968	1,464,443	102,316	(919,575)	-0-	833,739	58,167	655,869	45,716	700,086	48,811
Totals	$4,532,155	$316,471	($3,926,949)	$ -0-	$2,086,607	$145,284	$1,859,390	$129,378	$1,957,629	$136,254
	(From Audit Report)		(From Wisconsin Returns)		(From Schedule D)		(From Schedule E)		(From Schedule C)	
Differences With State Audit And:										
a) Separate Accounting			$2,459,104	$316,471						
b) Marketing Apportioned Only					$2,445,548	$171,187				
c) Marketing And Refining Apportioned Only							$2,672,765	$187,093		
d) Exploration And Production As Separate Business Or Allocation To Situs									$2,574,526	$180,217

NOTE: This schedule summarizes the resulting Wisconsin net taxable income and franchise tax liability under four alternative conclusions as to the method for arriving at the net income attributable to Humble's activities in Wisconsin during the years 1965 thru 1968.

1) Separate accounting for Wisconsin marketing activities, as reported in Humble's Wisconsin tax returns.
2) Marketing functional department's net income allocated and apportioned to Wisconsin under the statutory formula, and all other income treated as from separate out-of-state businesses.
3) Marketing and Refining functional departments' combined net income allocated and apportioned to Wisconsin under the statutory formula; and all other income treated as from separate out-of-state businesses.
4) Exploration and Production function's net income treated as (a) a separate out-of-state business, or (b) as income from "mining" allocated to situs, with all other non-allocable net income of Humble apportioned under the statutory three-factor formula.

Rather, the question is whether the state's grasp remains within the limits of constitutional mandates. This is borne out by the further comments of the court in *Moorman*, 437 U.S. at 272-274:

> "Yet even were we to assume that the Illinois activities made some contribution to the profitability of the Iowa sales, appellant's claim that the Constitution invalidates an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State is incorrect.
>
> "The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate business. First, no tax may be imposed, unless there is some minimal connection between those activities and the taxing State. *National Bellas Hess, Inc.* v. *Dept. of Revenue*, 386 U.S. 753, 756, 87 S.Ct. 1389, 1390, 18 L.Ed. 2d 505. This requirement was plainly satisfied here. Second, the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing state.' *Norfolk & Western R. Co.* v. *Missouri*, 390 U.S. 317, 325, 88 S.Ct. 995, 1001, 19 L.Ed. 2d 1201.
>
> "Since 1934 Iowa has used the formula method of computing taxable income. This method, unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State. The single-factor formula used by Iowa, therefore, generally will not produce a figure that represents the actual profits earned within the State. But the same is true of the Illinois three-factor formula. Both will occasionally over-reflect or under-reflect income attributable to the taxing State. Yet despite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula. . . .

> "In individual cases, it is true, the Court has found that the application of a single-factor formula to a particular taxpayer violated due process. See *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 51 S. Ct. 385, 75 L.Ed. 879; *Norfolk & Western R. Co.* v. *State Tax Comm.*, 390 U.S. 317, 88 S. Ct. 995, 19 L.Ed. 2d 1201. In *Hans Rees'*, for example, the Court concluded that proof that the formula produced a tax on 83% of the taxpayer's income when only 17% of that income actually had its source in the State would suffice to invalidate the assessment under the Due Process Clause. But in neither *Hans Rees'* nor *Norfolk & Western* did the Court depart from the basic principles that the States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State,' 283 U.S., at 135, 51 S. Ct., at 389, or has 'led to a grossly distorted result,' 390 U.S. at 326, 88 S. Ct. at 1002.'' 98 S. Ct. at 2344-2345.''

Exxon also argues that the Wisconsin apportionment formula violates the Commerce Clause since the sources of income derived from the exploration and production function were all in states other than Wisconsin.

However, the court in *Moorman* stated:

> . . . "Since there is no evidence in the record regarding the percentages of its total net income taxed in the other States in which it did business during those years, any claim that appellant was taxed on more than 100% of its total net income would also be speculative.'' 437 U.S. at 276, fn. 11.

Such evidence is also absent from the record in the instant case.

Using the figures from Exhibit thirty-five,[2] Wisconsin sales for the four years represented .41 percent of total

2. Exhibit 35:

HUMBLE OIL & REFINING COMPANY

1965–1968 Wisconsin Corporation Franchise Tax Audit
Comparison Of Net Income Of Total Company With Assessed Income From Wisconsin Operations

Year	(1) Wisconsin Sales	(2) Wisconsin Assessed Taxable Income	Net Income Percentage Of Sales	(3) Total Company Sales	(4) Total Company Net Income Wisconsin Basis	Net Income Percentage Of Sales
1965	$12,980,144	$ 759,371	5.9%	$ 3,462,675,348	$ 403,594,652	11.6%
1966	14,358,059	1,043,395	7.3%	3,480,707,694	468,647,833	13.5%
1967	16,350,330	1,264,946	7.7%	3,720,832,181	541,954,615	14.6%
1968	16,384,760	1,464,443	8.9%	3,984,479,455	608,009,771	15.3%
Totals	$60,073,293	$4,532,155	7.5%	$14,648,694,678	$2,022,206,871	13.8%

Notes:
1) From State Audit, Page 12 (Exhibit E-3) EXHIBIT # _____
2) From State Audit, Page 1 (Exhibit A-B) EXHIBIT # _____
3) See Computation Below
4) From State Audit, Page 2 (Exhibit C) EXHIBIT # _____

*3	1965	1966	1967	1968
Total Company Sales	$4,070,986,858	$4,095,866,931	$4,402,573,496	$4,708,312,[illegible]6
Adjustments				
1. Taxes on Products Sold	(604,793,382)	(611,275,049)	(677,457,213)	(719,189,807)
2. Cash Discounts	(3,518,128)	(3,884,188)	(4,284,102)	(4,643,126)
Total Adjusted Sales	$3,462,675,348	$3,480,707,694	$3,720,832,181	$3,984,479,455

* From State Audit, Page 12 (Exhibit E-3) EXHIBIT # _____

company sales ($60,073,293) divided by $14,648,694,678). Wisconsin assessed taxable income for the four years represented .22 percent of total company net income adjusted to a Wisconsin basis ($4,532,155 divided by $2,022,206,871). Wisconsin can hardly be accused of reaching out for more than its fair share of the taxpayer's income.

The taxpayer's activities have a "substantial nexus" with the state, as demonstrated by Wisconsin sales of $60,073,293 for the four year period of refined petroleum products and automotive accessories. As discussed above, the tax is fairly apportioned to represent only that part of the taxpayer's income which can be attributed to its Wisconsin activities. There has been no claim that the tax discriminates between interstate and intrastate commerce. Finally, the tax is "fairly related to services provided by the State." As the Supreme Court noted in *Japan Line, Ltd., supra* at 4480, such benefits "include not only police and fire protection, but the benefits of a trained work force and the advantages of a civilized society."

The fact that the producing states may impose production taxes which are a form of property tax[3] or severance taxes which have been held to be occupation taxes or property taxes[4] does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income. As the Supreme Court stated in *Western Live Stock* v. *Bureau of Revenue,* 303 U.S. 250, 254 (1938):

[3] Sullivan, *Handbook Of Oil & Gas Law,* (Prentice-Hall, Inc. 1955) p. 490.

[4] Summers, *Oil & Gas,* (Vernon Law Book Company, 1962) §801, p. 409.

"It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business, 'Even interstate commerce must pay its way.' "

QUESTION #3: IN APPLYING THE STATUTORY APPORTIONMENT FORMULA OF SEC. 71.07(2), STATS., (1967), DID THE DEPARTMENT PROPERLY WEIGHT THE COST OF MANUFACTURING FACTOR BY EMPLOYING A DIVISOR OF 2.6 INSTEAD OF 3?

Sec. 71.07(2), Stats., provides that after nonapportionable income is subtracted,

"The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:

"(a) The ratio of the tangible property, real, personal and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere. Cash on hand or in the bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be considered tangible property nor included in the apportionment. In determining apportionable net income with respect to the calendar year 1964 and corresponding fiscal years and thereafter, in any case in which the property factor is distorted by the taxpayer depreciating property in Wisconsin by a method different from that used to depreciate property outside Wisconsin, the department may determine the property factor by depreciating all property by the same method, or using original cost or any other means as will achieve an equitable result.

"(b) In the case of persons engaged in manufacturing or in any form of collecting, assembling or processing goods and materials, the ratio of the total cost of manufacturing, collecting, assembling or processing within this state to the total cost of manufacturing, or assembling or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing,' as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term shall be generally interpreted to include as elements of cost the following:

"1. The total cost of all goods, materials and supplies used in manufacturing, assembling or processing regardless of where purchased.

"2. The total wages and salaries paid or incurred during the income year in such manufacturing, assembling or processing activities.

"3. The total overhead or manufacturing burden properly assignable according to good accounting practice to such manufacturing, assembling or processing activities.

"(c) In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year."

Three factors are to be used in computing the apportionable income—sales, property and manufacturing costs. The Department weighted down the cost of manufacturing because not all of the products sold through Humble's marketing system in Wisconsin were manufactured by Humble.

Sec. 71.07(2)(b) provides that

"Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term [cost of manufacturing] shall

be generally interpreted to include as elements of cost the following. . . ."

The Department has employed weighting since 1932. Long-standing administrative construction of a statute is accorded great weight in the determination of legislative intent because the legislature is presumed to have acquiesced in that construction if it has not amended the statute. *Layton School of Art & Design* v. *WERC,* 82 Wis. 2d 324, 340, 262 N.W. 2d 218 (1978). The practice has also been approved by the Tax Appeals Commission and its predecessor, the Board of Tax Appeals, in *Kroger Company* v. *Wisconsin Dept. of Taxation,* 4 WBTA 319 (1956), and *Cooper's Inc.* v. *Wisconsin Dept. of Revenue,* 9 WTAC 342 (1973). The subdivisions of the statute set forth statutory ratios for the apportionment method but give the department considerable latitude in adopting a formula which will most accurately reflect a reasonable and equitable tax on the income earned in Wisconsin. *Interstate Finance Corp., supra,* 28 Wis. 2d at 271-72.

Exxon argues that the department lacked authority to adjust the apportionment ratios, because sec. 71.07(5) provides:

> "(5) If the income of any such person properly assignable to the state of Wisconsin cannot be ascertained with reasonable certainty by either of the foregoing methods, then the same shall be apportioned and allocated under such rules and regulations as the department of taxation may prescribe."

and the department had no published rules and regulations on the subject.

However, the department had sufficient authority to make such adjustments under sec. 71.07(2)(b), without relying on sec. 71.07(5).

The department, however, is not free to entirely disregard the statute. In *Department of Taxation* v. *Blatz Brewing Co.,* 12 Wis. 2d 615, 108 N.W. 2d 319 (1961), the department determined the location of returnable containers owned by Blatz for purposes of the property ratio by using the sales ratio. The court found this impermissible saying:

> "The action of the board of tax appeals, in holding that in the absence of definite proof, the property factor should be based on sales, was arbitrary and capricious. It follows that the allocation of these containers on sales alone, as was done in the modified additional assessment and approved by the board, or on the basis of 50 per cent to sales and 50 per cent to manufacturing, as now contended by the department, cannot be sustained, because those contentions are based on an erroneous theory and ignore the weight of the property factor in the formula. Such contentions reduce the three-factor formula to a two-factor formula in this case. The department is bound to use the statutory method even though another method may appear convenient or expedient to it." *Id.* at 627.

In the instant case, it is conceded that Humble had no manufacturing in the state, so the numerator of the cost of manufacturing ratio is zero. For purposes of calculating the denominator of the ratio, the department attempted to recognize only the cost of products manufactured by Humble and not those purchased from other vendors. To do this, the department used the ratio of net sales producing apportionable income to total manufactured products sold. This was improper under *Blatz.* We agree with the trial court that this question should be remanded to the Commission to determine whether the weighting method used by the Department was justified under the circumstances, and whether the formula as weighted unfairly apportioned the taxpayer's income for the years at issue. We also note that the burden of proving that the formula adopted unfairly apportioned Humble's income is on Exxon. *W. R. Arthur & Co.* v. *Dept. of Revenue,* 18 Wis. 2d 225, 232, 118 N.W. 2d 168 (1962).

By The Court: Judgment affirmed in part, reversed in part, and remanded for further proceedings consistent with this opinion.

APPENDIX B

STATE OF WISCONSIN
CIRCUIT COURT — DANE COUNTY

Case No. 151-344

WISCONSIN DEPARTMENT OF REVENUE,
Petitioner,

vs.

EXXON CORPORATION,
Respondent.

Before: Hon. George R. Currie, *Reserve Circuit Judge*

JUDGMENT

The above entitled review proceeding having been heard by the Court on the 18th day of January, 1977, at the City-County Building in the City of Madison; and the petitioner having appeared by Assistant Attorney General E. Weston Wood; and the respondent having appeared by Attorneys Thomas G. Ragatz, James F. Lorimer, Lloyd M. McBride, Robert E. Tannehill, and Paul D. Frenz; and the Court having had the benefit of the argument and briefs of counsel; and the Court having filed its Memorandum Decision wherein Judgment is directed to be entered as herein provided, which Memorandum Decision is incorporated herein by reference and made a part hereof;

It is Ordered and Adjudged that Findings of Fact Numbers 19, 21, and 23, and Conclusions of Law Numbers 3, 6, and 7, and the Order portion of the Decision of the Wisconsin Tax Appeals Commission dated April 8, 1976, entered in the matter of Exxon Corporation, f/k/a Humble Oil and Refining Company, Petitioner vs. Wisconsin Department of Revenue, Docket No. I-3806, be, and the same hereby are, set aside, and the matter be remanded to the Commission for further proceedings consistent with the Court's said Memorandum Decision.

Dated this 31st day of January, 1977.

By the Court:

George R. Currie
Reserve Circuit Judge

STATE OF WISCONSIN

CIRCUIT COURT — DANE COUNTY

Case No. 151-344

WISCONSIN DEPARTMENT OF REVENUE,

Petitioner,

vs.

EXXON CORPORATION,

Respondent.

Before: Hon. George R. Currie, *Reserve Circuit Judge*

MEMORANDUM DECISION

This is a proceeding under ch. 227, Stats., to review a decision of the Wisconsin Tax Appeals Commission (hereafter the Commission) dated April 8, 1976, which modified the action taken by petitioner department on respondent Exxon's application for abatement of assessment of additional income and franchise taxes for the calendar years 1965 through 1968.

During these four years the taxpayer whose operations in Wisconsin gave rise to this assessment of additional tax was Humble Oil and Refining Company, a wholly-owned subsidiary of Standard Oil Company of New Jersey. Later the latter corporation changed its name to Exxon Corporation.

THE COMMISSION'S FINDINGS OF FACT

The Commission's findings of fact read as follows:

Number 1. The petitioner is a corporation organized under the laws of the State of Delaware with its general offices located in Houston, Texas.

Number 2. During the years here under review, 1965 through 1968, Humble Oil and Refining Company was a wholly-owned subsidiary of Standard Oil Company of New Jersey. In early 1973, Humble Oil and Refining Company was merged into the parent company and the latter's name was changed to Exxon Corporation.

Number 3: The three principal operating or functional departments of the petitioner are exploration and production, refining, and marketing, each organized into regional geographic divisions. The marketing department has nation-wide jurisdiction and is headed by a vice-president located in Houston, Texas. Wisconsin is one of thirteen states in the central marketing region.

Number 4. The petitioner's three principal operating departments, exploration and production, refining, and marketing, were organized and operated as separate segments and separate functional operations of the petitioner's total corporate enterprise.

Number 5. During the years here under review, the petitioner's activity in Wisconsin was the marketing of refined petroleum products and automotive accessories. It had no exploration, production, or refining facilities located in Wisconsin.

Number 6. During the period here under review, the petitioner carried on its marketing operations in Wisconsin primarily through service stations, terminals, and bulk storage facilities.

Number 7. Pursuant to an exchange agreement between the petitioner and Pure Oil Company (a nonrelated company), gasoline and fuel oil were transported by the petitioner from Lemont, Illinois to its terminals in Wisconsin. Such products were sold by the petitioner in Wisconsin. None of the petitioner's own refined gasoline and fuel oil were sold in Wisconsin during the years 1965 through 1968.

Number 8. Motor oils, greases, and other packaged products were, during the period here under review, produced and manufactured by the petitioner outside of Wisconsin and were shipped into Wisconsin for sale in Wisconsin from petitioner's central warehouse facilities in Chicago, Illinois and from other out-of-state locations.

Number 9. During the period here under review, tires, batteries, and accessories were centrally purchased by the petitioner's purchasing office in Houston, Texas and were shipped from out-of-state locations into Wisconsin for sale.

Number 10. The petitioner utilized internal transfer prices between its functional departments that were the equivalent of third-party competitive prices.

Number 11. During the period here under review, the petitioner's exploration and production and refining departments had no operations or activities in the State of Wisconsin.

Number 12. During the period here under review, the petitioner carried on centralized purchasing for all its operating divisions; and centralized advertising was directed from the home office in Houston, Texas on a uniform nation-wide basis.

Number 13. During the period involved herein, key employees of the petitioner were transferred from one department to another as a method of employee training.

Number 14. During the period involved herein, the petitioner used a uniform credit card system throughout the United States including Wisconsin.

Number 15. During the period here under review, the petitioner utilized centralized accounting methods under the direction of its Houston home office.

Number 16. During the period here under review, the petitioner had in effect a company-wide stock option and bonus plan, which included its Wisconsin operations.

Number 17. During the period here under review, the petitioner's home office in Houston, Texas was responsible for and/or directed pricing policy, drafting of uniform selling forms and contracts, product guarantees or warranties, establishment of sales districts, negotiation and execution of exchange agreements, location of new service station outlets, approval of operating budgets, banking and investment of funds, utilization of legal services, preparation of federal and state tax reports, borrowing money, approval of salary increases and retirement plans, paid vacation plans, and health and accident insurance, all on a company-wide basis.

Number 18. During the period involved herein, income derived from each of the petitioner's functional operating departments could be determined from the petitioner's books and records.

Number 19. The petitioner's three main functional operating departments, exploration and production, marketing, and refining, were each unitary businesses.

Number 20. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's exploration and production function.

Number 21. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its exploration and production function.

Number 22. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's refining function.

Number 23. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its refining function.

Number 24. During the period involved herein, the petitioner's Wisconsin marketing operations were an integral part of the petitioner's overall marketing function.

Number 25. The petitioner filed Wisconsin corporation franchise or income tax returns for the calendar years 1965 through 1968 based on the separate accounting method of reporting its income to the State of Wisconsin. In said returns, losses were shown in the amounts of $821,320, $1,159,830, $1,026,224 and $919,575, respectively, for such years.

Number 26. Under date of June 25, 1971, the respondent, Wisconsin Department of Revenue, issued a notice of assessment of additional income and franchise taxes against the petitioner, Exxon Corporation, covering the years 1965 through 1968.

Number 27. In said assessment, the respondent determined that the petitioner realized additional net income in the amounts of $759,371, $1,043,395, $1,264,946, and $1,464,443 for the years 1965 through 1968, respectively, and computed additional Wisconsin franchise tax thereon totaling $316,470.85.

Number 28. The assessment here under review was based on a field audit of the petitioner's books and records conducted by the respondent covering the years here under review. In the course of said audit, the respondent determined that the petitioner's separate accounting method of reporting its income to the State of Wisconsin did not accurately reflect its Wisconsin taxable income. The respondent recomputed the petitioner's income/franchise tax liability on the three-factor apportionment basis provided for in Section 71.07 of the Wisconsin Statutes, and further weighted the cost-of-manufacturing factor in the formula it utilized.

Number 29. Under date of July 21, 1971, the petitioner filed an application for abatement of the said additional assessment with the respondent.

Number 30. Under date of November 30, 1971, the respondent denied the said application for abatement.

Number 31. On December 30, 1971, the petitioner filed a petition for review with this Commission.

Number 32. The apportionment formula utilized by the respondent had the effect of imposing a tax on the petitioner's exploration and production and on its refining net income, all of which was derived solely from operations outside the State of Wisconsin and which had no integral relationship to the petitioner's marketing operations within Wisconsin.

Number 33. The respondent's taxation of net income from the petitioner's exploration, production and refining functions subjects the petitioner to multiple-state taxation as to such income.

Number 34. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.

Number 35. The petitioner's method of reporting its income to Wisconsin on a separate accounting basis did not accurately reflect its Wisconsin income.

The department challenges Findings Numbers 4, 19, 20, 21, 22, 23, 32, 33 and 34 as being erroneous conclusions of law and not true findings of fact, and contends that, if it does not prevail on that ground as to any of such findings, then the Court should determine that such findings are not supported by substantial evidence in the record.

The Court is satisfied that Findings Numbers 4, 33, and 34 are true findings of fact; and determines they are supported by substantial evidence in the record except possibly that portion of Finding Number 33 which in effect finds that the inclusion of income from taxpayer's refining functions in the apportionment formula applied by the department in making the assessment of additional tax subjected taxpayer to multiple-state taxation as to such income.

With respect to the other challenged findings the Court determines that they are either wholly or partially conclusions of law, and will be hereinafter dealt with.

The failure of the department to challenge any of the findings of fact other than the nine listed above amounts to a concession of the facts stated in the remaining twenty-six findings of fact.

THE COMMISSION'S CONCLUSIONS OF LAW

Neither party challenges Conclusions of Law Numbers 1 and 2. The remaining conclusions of law read:

> Number 3. During the years in issue, the petitioner was operating a multi-state unitary marketing business within the intent and meaning of Section 71.07(2) of the Wisconsin Statutes, and the petitioner's Wisconsin marketing operation was an integral part thereof.
>
> Number 4. Under the provisions of Section 71.07(2) of the Wisconsin Statutes, it was mandatory for the petitioner to use the apportionment method of reporting its income for Wisconsin franchise tax purposes.
>
> Number 5. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.
>
> Number 6. The apportionment formula used by the respondent in the audit and assessment here under review was improper in including income from petitioner's exploration, production and refining departments, and resulted in assessing a tax on an extra-territorial income earned by the petitioner.
>
> Number 7. An apportionment formula, apportioning income earned by the petitioner from its marketing function within and without the State of Wisconsin, would be proper and within the intent and meaning of the statutory mandate contained in Section 71.07(2) of the Wisconsin Statutes.

The effect of these conclusions of law was that the Commission determined that Humble's marketing department,

which encompassed all business which it transacted in Wisconsin, was in itself a unitary business and for purposes of Wisconsin's income and franchise tax its income was to be taxed according to the apportionment formula set forth in sec. 71.07(2) Stats., as that statute read during the years at issue.

HUMBLE'S CORPORATE ORGANIZATION STRUCTURE

Humble's corporate organizational structure during the years at issue was subdivided into these three parts: Corporate management, coordination and services management, and operations management. In this review the Court is concerned only with operations management.

Operations management was responsible for directing the operating activities of the several individual functional segments of Humble's business which consisted of exploration and production, refining, marketing, marine, coal and shale oil, minerals, and land management. For the purposes of this decision the exploration and production function will be referred to as the exploration and production department although actually composed of three departments, viz., exploration, production, and natural gas.

The three departments dealt with in the Commission's findings of fact are exploration and production, refining, and marketing. Each of these three functional departments had a full management complement, and each was a separate profit center having its own accounting office which recorded and reported the cost analysis and the financial results of its operations.

STATUTES INVOLVED

The statutory provisions here quoted under this heading are those in effect during 1965 through 1968.

Section 71.01(2) provided in part:

> "(2) *Franchise Tax on Corporations.* For the privilege of exercising its franchise or doing business in this state in a corporate capacity every . . . foreign corporation . . . shall annually pay a franchise tax according to or measured by its entire net income of the preceding income year at the rates set forth in S. 71.09 (2am). . . . All provisions of Chs. 71 and 73 relating to net income taxation of corporations shall apply to franchise taxes imposed under this subsection, unless the context requires otherwise. . . ."

Section 71.07 provided in part:

> "(1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived. . . ."
>
> "(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible,

> the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:
>
> "(a) The ratio of the tangible property, real, personal, and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere. Cash on hand or in the bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be considered tangible property nor included in the apportionment. In determining apportionable net income with respect to the calendar year 1964 and corresponding fiscal years and thereafter, in any case in which the property factor is distorted by the taxpayer depreciating property in Wisconsin by a method different from that used to depreciate property outside Wisconsin, the department may determine the property factor by depreciating all property by the same method or using original cost or any other means as will achieve an equitable result.
>
> "(b) In the case of persons engaged in manufacturing or in any form of collecting, assembling or processing goods and materials, the ratio of the total cost

of manufacturing, collecting, assembling or processing within this state to the total cost of manufacturing, or assembling or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing', as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term shall be generally interpreted to include as elements of cost the following:

"1. The total cost of all goods, materials and supplies used in manufacturing, assembling or processing regardless of where purchased.

"2. The total wages and salaries paid or incurred during the income year in such manufacturing, assembling or processing activities.

"3. The total overhead or manufacturing burden properly assignable according to good accounting practice to such manufacturing, assembling or processing activities.

"(c) In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year.

"* * *

"(5) If the income of any such person properly assignable to the state of Wisconsin cannot be ascertained with reasonable certainty by either of the foregoing methods, then the same shall be apportioned and allocated under such rules and regulations as the department of revenue may prescribe."

WISCONSIN ADMINISTRATIVE CODE RULE INVOLVED

Rule TAX 2.42 provides in part:

"TAX 2.42. Apportionment method. (Section 71.07(2), Wis. Stats.) Any person engaged in business within and without the state must report by the statutory apportionment method when the business of such person within the state is an integral part of a unitary business, unless the department of taxation expressly permits reporting on a different basis."

PROCEDURAL ISSUES AND THEIR DISPOSITION

These two procedural issues are raised by the briefs:

(1) Did the Commission err as a matter of law in refusing to take judicial notice pursuant to motion made by the department of two bound volumes entitled "The Petroleum Industry, Hearings Before the Subcommittee on Anti-Trust and Monopoly of the Committee on the Judiciary, United States Senate, September 23, 26, October 29, 31, November 12, and 19, 1975, part 1 and part 2"?

(2) Is the scope of review by this Court governed by sec. 227.20(1), Stats., 1973, or by sec. 227.20, (1)-(9), as created by Section 25 of Chap. 414, Laws of 1975, effective September 22, 1976?

(a) *Judicial Notice Issue*

This issue was raised by a supplement to the department's original brief, which supplement is dated October 27, 1976. It appears therefrom that the Commission's ruling on the department's motion to take judicial notice of the two bound volumes described above was by oral ruling made April 7, 1976. The department's supplement to its brief stresses these two portions of the two bound volumes of which it desired to have judicial notice taken: (1) A

letter dated January 6, 1976, from Exxon's controller, A. L. Monroe, to Senator Hart, Chairman of the Senate Subcommittee; and (2) Exxon's answers to a request made to it by the South Carolina Tax Commission to admit certain facts, which request was made in a court action pending in a state court in South Carolina. These answers by Exxon were verified by the oath of a vice president on November 21, 1975. The department contended that this material conflicted with testimony given in behalf of Exxon at the hearing before the Commission with respect to Humble's method of separate accounting being maintained with respect to each of its operating departments, and that Humble's business during the four tax years here involved was not a unitary business. The department asserts that judicial notice should have been taken of this material because it bore on the credibility of witnesses who had testified at the hearing.

It thus appears that the particular facts of which the department sought to have judicial notice taken were adjudicative and not legislative facts. Wisconsin recognizes the distinction between adjudicative and legislative facts for purposes of taking judicial notice. Sec. 902.01, Stats., and Judicial Council Committee's Note to sub. (1) thereof set forth in 56 Marquette Law Rev. (1973) 173; *Fringer* v. *Venema* (1965), 26 Wis. 2d 366, 132 N.W. 2d 565. Sub. (1) of sec. 902.01, Stats., provides that this section of the statutes only governs adjudicative facts, and sub. (2) provides:

> "A judicially noticed fact must be one not subject to reasonable dispute in that it is either (a) generally known within the territorial region of the trial court or (b) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."

While sec. 227.10(1), Stats., provides that administrative agencies shall not be bound by common law or statutory rules of evidence, the Commission had the right in its discretion to apply sec. 902.01(2), Stats., and deny the department's request to take judicial notice of the Monroe letter and Exxon's admission of facts in the South Carolina court action as not being supplied by sources whose accuracy cannot reasonably be questioned. A further sound basis for denial was that the facts covered by the Monroe letter and the admission of facts were too remote in time to the years 1965 through 1968, and related to Exxon as a whole and not to its former subsidiary Humble.

Obviously what the department was attempting to do was to get evidence before the Commission which the department considered to be admissions by Exxon. Judicial notice is not the proper method to be employed in proving admissions.

(b) *Which Statute Governs the Scope of Review*

This Court recently had before it the issue of whether the provisions of sec. 227.20(1), Stats., as it stood prior to its repeal and the creation of new sec. 227.20(1)-(9) by ch. 414, Laws of 1975, in *Town of Hewitt* v. *Wisconsin Department of Natural Resources,* Case No. 151-148, Dane County Circuit Court (December 3, 1976). The new statute had become effective September 22, 1976, after the date of the agency decision had been rendered, but prior to the Court's review thereof. The Court held that the new statute was a procedural and not a substantive statute and therefore governed the scope of the Court's review. On further consideration the Court deems this is true except as to any provision which narrowed the scope of review, and no contention has been advanced here that any provision does this.

The Court can perceive no practical distinction between the application of former sec. 227.20(1)(d) and new sec. 227.20(6) with respect to the power of the reviewing court to set aside agency findings not supported by substantial evidence. The decisions of the Wisconsin Supreme Court defining substantial evidence under former sec. 227.20 (1)(d) are equally applicable to what constitutes substantial evidence under new sec. 227.20(6).

The scope of review with respect to setting aside agency decisions for error of law appear to be the same under new sec. 227.20(8) and former sec. 227.20(1)(b).

ISSUES GOING TO MERITS OF CONTROVERSY

The issues raised with respect to the merits of the controversy are:

(1) Was taxpayer Humble a unitary business within the meaning of sec. 71.07(2), Stats., as that statute existed during the years 1965 through 1968?

(2) If Humble was a unitary business, did the department err in its interpretation of sec. 71.07(2), Stats., by including in the formula income which should have been excluded as situs income?

(3) Did the department err in adopting an apportionment formula which did not follow that prescribed by sec. 71.02(2), Stats., as it existed in the years at issue?

HUMBLE AS A UNITARY BUSINESS

Section 71.07(2), Stats., as it existed during the years 1965 through 1968 had the effect of requiring the application of an apportionment formula in determining the income and franchise tax of a taxpayer whose business in Wisconsin was "an integral part of unitary business", and

permission had not been properly granted by the department to employ the allocation and separate accounting method of reporting.

There have been several Wisconsin Supreme Court cases which have dealt with the problem of what constitutes a unitary business for the purposes of this statute. While there may not exist any inconsistency in result in these cases it appears that there has been some shifting in the criteria employed to determine what constitutes a unitary business for purposes of this statute. This Court is satisfied that the Supreme Court in *Interstate Finance Corp.* v. *Dept. of Taxation* (1965), 28 Wis. 2d 262, 137 N.W. 2d 38, has adopted the test of a unitary business which it will adhere to in future decisions. The opinion in that case was written by the present Chief Justice of the Court. The test thus adopted is one set forth in Allocation of Income in State Taxation (2d ed.) by Altman & Keesling, p. 101, and appears in this quotation therefrom in the opinion (at p. 269):

> " '. . . the essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary.' "

Keesling, (his name was misspelled "Kiesling" in *Interstate Finance Corp.*) one of the two authors of *Allocation of Income in State Taxation* (2d ed.), testified at the hearing before the Commission as an expert witness for the department. He pointed out that the test set forth in the above quotation from the book is in the alternative and not the conjunctive. As Exxon points out, however, in an article Keesling co-authored in 12 Hastings Law Journal (1960) 42, 48, entitled The Unitary Concept, it was stated that dependency alone was not sufficient to make a business

conducted in more than one state unitary. When questioned on cross examination about this change in view, he explained that it was the result of a decision by the California Supreme Court in the *Superior Oil Co.* case. This case is probably *Superior Oil Co.* v. *Franchise Tax Board* (1963), 34 Cal. Rptr. 545, 386 P.2d 33. This is probably all beside the point because the *Interstate Finance Corp.* case has adopted the alternative and not the conjunctive test.

Finding of Fact Numbers 7, 8, and 9 describe the sources from which Humble's sales outlets in Wisconsin, part of its marketing department, obtained the products which were sold there. All gasoline and fuel oil were obtained from Pure Oil Company (a non-related company) at Lemont, Illinois, and transported into Wisconsin pursuant to an exchange agreement whereby an equal supply of gasoline and fuel oil was supplied to Pure Oil Company by Humble at a location in a state other than Illinois or Wisconsin. This gasoline and fuel oil exchanged by Humble had been processed at one of its refineries from crude oil produced by it from its oil wells. Motor oils, greases, and other products sold in Wisconsin were produced and manufactured by Humble outside Wisconsin. Tires, batteries and other accessories sold in Wisconsin were centrally purchased by Humble's purchasing office in Houston, Texas.

There was no financial dependency by Humble's marketing department activities in Wisconsin because the transfer prices utilized by Humble with respect to the products sold in Wisconsin in the separate accounting maintained for its marketing department were the equivalent of third-party competitive prices as found by Finding of Fact Number 10. In other words the marketing department could have gone into the open market and bought these products at the same prices as the transfer prices charged to it in Humble's accounting procedures.

In the *Interstate Finance Corp.* case it was argued that the Wisconsin branches of taxpayer could have borrowed the money they needed to operate their finance operations from the same sources as home management had utilized and could have operated successfully without control or supervision of the home management. However, the Supreme Court held they could not operate independently because of the policies, direction and control of the home office, and this constituted a dependency. While Humble's marketing department operated with a great deal of autonomy from central management, it would be wholly unreasonable to conclude that central management would have permitted its marketing department to acquire the products Humble sold in Wisconsin from sources other than Humble.

The Wisconsin operation contributed sales to Humble's business of producing, refining and marketing petroleum products. This contribution was sufficient alone in the opinion of this Court to make Humble's business a unitary one. The profitability of the sales contributed is not an element to be considered in determining whether a unitary business existed.

Whether a business is unitary within the meaning of sec. 71.07(2), Stats., as it existed in the years 1965 through 1968, presents a question of law and not of fact. Therefore, any findings of fact which have the effect of determining that Humble's marketing department's operations were not part of a unitary business are erroneous conclusions of law. The Court will now consider certain findings of fact which the department has attacked as being erroneous conclusions of law.

Finding of Fact Number 19 is an erroneous conclusion of law in holding that Humble's three main functional operating departments were each unitary businesses.

Finding of Fact Number 20 held that Humble's marketing operations in Wisconsin were not an integral part of Humble's exploration and production function. It is immaterial that the gasoline and fuel oil sold in Wisconsin were not produced by Humble's oil wells, but were procured through an exchange made with Pure Oil Company. What made possible the exchange was the furnishing of Pure with gasoline and fuel oil by Humble which had their source in Humble's oil wells. Because both Humble's marketing operations in Wisconsin and its exploration and production function are integral parts of a unitary business does not mean that each is an integral part of the other. The Court can perceive no reason for disturbing this finding.

For the same reason the Court will not set aside Finding of Fact Number 22.

Finding of Fact Numbers 21 and 23 found there was no economic dependence between Humble's Wisconsin marketing operations and either its exploration and production function or its refining function. The Court has determined that there was such economic dependence because Humble depended upon its exploration and production function and its refining function to provide its Wisconsin marketing operations with the gasoline and fuel oil sold in Wisconsin even though none of such gasoline and fuel oil sold in Wisconsin had its origin in Humble's oil wells. Therefore, these two findings are erroneous conclusions of law.

Finding of Fact Number 32, as well as Finding of Fact Numbers 20 and 22, are couched in terms of one department being an integral part of another department and will not be set aside.

In conclusion the Court determines that the business of Humble during the years in question considered as a whole

both within and without Wisconsin constituted a unitary business within the meaning of sec. 71.07(2), Stats., as that statute existed during the years 1965 through 1968.

EXCLUSION OF SITUS INCOME

Section 71.07(1), Stats., as it existed in 1965 through 1968, contained this provision:

> "Income or loss *derived from* rentals and royalties from real estate or tangible personal property, or from the operation of any farm, *mine* or quarry, or from the sale of real property or tangible personal property shall follow the *situs* of the property from which *derived.*" (Emphasis supplied.)

While sec. 71.07(1) governs taxation of income from a business not requiring apportionment, a comparable provision to that quoted above serving a like purpose was set forth in sec. 71.07(2) as it existed during the years at issue, read:

> "In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer *such part thereof* (less related expenses, if any) as follows the situs of the *property . . . of the recipient . . . .*" (Emphasis supplied.)

With respect to what income follows the situs of the property it is clear that this is spelled out in the extract from sec. 71.07(1) quoted above. It was fully conceded by witnesses from the department that the extraction and production of oil and gas is "mining" within the meaning of Section 71.07(1) (Exhibit 7, pp. 71, 72, 81; Exhibit 8, p. 74; Exhibit 9, p. 15; Exhibit 10, p. 12). And in two recent cases the Commission has held oil and gas operations to be situs operations under Section 71.07(1): *Leonard R. Jevne* v. *Wisconsin Department of Revenue* Docket No.

I-4956; April 14, 1976 (CCH par. 201-224); *Deane A. Neitzel* v. *Wisconsin Department of Revenue,* Docket No. I-4872; November 17, 1975 (CCH par. 201-186).

In this case with respect to crude oil produced by Humble the department devised and applied what is termed the "barrel formula" as a means of separating two sets of income figures: (a) that derived from the sale to third parties of crude oil produced by Humble; and (b) that derived from crude oil produced by Humble and transferred to its refineries. The former was allocated to situs and the latter was left in the apportionment formula.

It is conceded that the part of Humble's production of crude oil which was transferred to its refining department was charged to that department in all instances at a transfer price based on "posted field prices", or at the identical prices received by Humble for the sale of that portion of its production of crude oil sold to outsiders.

In the case of gas produced by Humble, some dry gas was sold to third parties at the wellhead; some "wet" gas was run through field separators and then sold to third parties; much of the "wet" gas was run through so-called gas plants, where a more sophisticated separation process took place (but with no molecular or chemical change taking place), after which some sales were made to third parties and the balance was introduced into Humble's transmission system for sales along that system; and, with respect to usage by Humble, some of its produced gas was used by it in the production field and some (about 4%) was transferred for fuel consumption (not product conversion) to Humble's refineries. Such of the gas as was employed for field use by Humble or transferred for fuel consumption at Humble's refineries was valued at arm's length field prices.

As in the case of the crude oil, the department attempted to segregate the income derived from sales of gas to third parties which it treated as excludable situs income, and all other income of Humble's production department from gas production was made subject to apportionment even though in Humble's accounting for that department such gas had been valued at arm's length field prices.

It is very clear to the Court that the department did not exclude from Humble's income subject to the application of the apportionment formula all situs income that was *derived* by Humble from its oil and gas wells. Humble's accounting records establish what the total of that situs income was based upon the value of the crude oil at posted field prices and of the gas at arm's length field prices.

The fact that part of Humble's production of crude oil was refined in its refining department and the end products sold through its marketing department is a proper factor taken into consideration in determining its business during the years at issue as having been a unitary one. However, this did not enhance the value of the crude oil and gas at wellhead beyond such posted field prices of crude oil and field prices of gas. There is nothing in the record alluded to in the briefs which give any indication that there was not a ready market for all of the crude oil and gas Humble produced. The evidence is undisputed that some companies in the petroleum industry engage only in the functions performed by Humble's exploration and production department.

It is the department's theory that non-apportionable situs income must be confined to *realized* income from actual sales to third parties. Nowhere, however, does the statute speak in terms of *realized* income in excluding situs income from application of the apportionment formula; it speaks only in terms of *derived* income.

The Commission expressly found by Finding of Fact Number 33 that the department's taxation of net income derived from Humble's exploration and production functions subjected Humble to multiple state taxation as to such income. This finding is supported by the testimony of Wehner, an expert witness in the field of accounting and taxation of the petroleum and gas industries. At the time of testifying he was the head of the Houston office of Arthur Andersen & Company, one of the largest firms of certified public accountants in the country. Prior to that for fifteen years he had been in charge of oil and gas taxation policies for the entire firm, not merely its Houston office. He had also served as special consultant to the United States Treasury Department. He testified Texas, Louisiana, Oklahoma, Colorado and probably California impose severance taxes on oil and gas production; and the posted field prices for crude oil and the Fiske formula method of back-up to wellhead gas prices are used in determination of values for these severance taxes. Thus there is no question but that the department's inclusion of Humble's income derived from crude oil and gas produced and not sold to third parties by Humble's production department resulted in double taxation of such income.

This feature of double taxation of situs income was emphasized by the Minnesota Supreme Court in *Skelly Oil Company* v. *Commission of Taxation* (1964), 239 Minn. 351, 131 N.W.2d 632, in refusing to permit income from Skelly's out-of-state production activities to be taxed by an apportionment formula applicable to a unitary business. In its decision that court declared (131 N.W. 2d 632 at p. 643):

> ". . . Skelly's production income was already subject to being taxed in full at the point of production. While taxation of the same income more than once

> may not be unlawful, depending upon circumstances, *Cream of Wheat Co.* v. *County of Grand Forks,* 253 U.S. 325, 330, 40 S.Ct. 558, 560, 64 L. Ed. 931, 934, it is nevertheless offensive to common concepts of what constitutes fairness, particularly when it is multiple taxation of the sort the board's unsupported conclusion produces in the instant case."

Likewise the department's attempt to interpret the situs exclusions of secs. 71.07(1) and 71.07(2) so as to only exclude Humble's income from crude oil and gas sold to third persons at situs of origin, and subjecting the remainder of such situs income to taxation through application of an apportionment formula with resulting double taxation of the same, is offensive to this Court's concept of what constitutes fairness. The Court does not believe that this unfair result was intended by the legislature. The intent of the legislature is made clear by the opening sentence of sec. 71.07(2), Stats., "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state."

The department's reply brief contends that the department's interpretation of the situs exclusionary provision of sec. 71.07(2) is a reasonable one and should be accorded weight because it is one the department has followed for some years. The Court deems that *Transamerica Financial Corp.* v. *Wisconsin Dept. of Revenue* (1972), 56 Wis. 2d 57, 201 N.W. 2d 552, repudiates that argument. There the department sought to limit the deduction of interest and dividends received as against the taxpayer's claim for *total* deduction before the application of the apportionment formula. The Supreme Court flatly held for the taxpayer by observing that "total" means "all, not part". And in countering the department's plea that its action

was consistent with long, established custom, the Court succinctly observed (56 Wis. 2d 67, 201 N.W. 2d at 557):

> "The department further argues that the assessments made here are in accord with the interpretation of the statute for many years, since 1932, and is entitled to great weight in construing the statute. We think administrative construction is not to be given force where it is inconsistent with an unambiguous statutory provision. . . ."

It is the Court's determination that on remand in computing the net income of Humble for the four tax years at issue which is subject to the apportionment formula there shall be deducted from the total net income such part thereof as constitutes situs income derived from the production of crude oil, whether sold to third parties by Humble's exploration and production department or transferred to its refining department, and all situs income derived from the production of natural gas as the same may be determined by the Commission.

Exxon's brief points out that the department in its audit upon which its assessment of tax was based made no deduction from net income attributable to Humble's functional operations identified as "Marine", "Coal and Shale Oil", "Minerals" and "Land Management". As the titles of these operations indicate, they are involved in shipping operations and in the exploration for and mining and extraction of coal, minerals and shale oil and the rental and sale of real estate, some at least being situs income operations (Tr. Vol. III, pp. 3-7). Therefore, on remand the Commission shall determine the amount of any situs income derived from these operations properly deductible from Humble's total net income for the years at issue in determining the amount of net income to which the apportionment formula is to be applied.

VARIATIONS IN STATUTORY APPORTIONMENT FORMULA

In computing the apportionment formula prescribed by sec. 71.07(2), Stats., as it existed during the years at issue, the three factors to be utilized are sales, property, and manufacturing costs. Exxon's brief asserts that the department employed a divisor of approximately 2.6 in determining the arithmetical average instead of 3 as prescribed by the statute. On the other hand, the department's reply brief indicates that what the department did was to weight the cost of manufacturing labor because not all of the products sold through Humble's marketing department were manufactured by Humble. Finding of Fact Number 9 lists products of this kind not manufactured by Humble.

In support of the adjustment made by the department in the apportionment formula the department's reply brief cites the testimony of Hoel, its supervisory employee who signed the letter of assessment (Exhibit 1). He testified: If a company manufactures part of the goods it sells and purchases others, the cost of manufacturing factor should not receive the full importance of the other two factors. For example, if the company manufactures one-half of what it sells, this cost of manufacturing factor should receive only 50 percent weight (Tr. October 8, p. 145). This weighting procedure has been used by petitioner since 1932; under varying circumstances it may result either in increasing or decreasing taxable income (Tr. October 8, p. 144). The method of weighting may be based on the ratio of cost of manufactured products sold to total cost of sales, or on the ratio of the selling price of manufactured products to total sales. Exhibit 34 shows by examples the results achieved by weighting the cost of manufacturing factor.

There were in existence during the years at issue two statutory provisions which might be contended authorized the department to vary the apportionment formula because of the facts stressed in Hoel's above summarized testimony for doing so, viz., sec. 71.07(2)(b) and sec. 71.07(5), Stats.

Sec. 71.07(2)(b) provided:

> "Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term [cost of manufacturing] shall be generally interpreted to include as elements of cost the following:" (and then lists total costs of goods, materials and supplies, total wages and salaries, and total overhead and manufacturing burden properly assignable to manufacturing activities).

Sec. 71.07(5) provided:

> "If the income of any such person properly assignable to the state of Wisconsin cannot be ascertained with reasonable certainty by either of the foregoing methods, then the same shall be apportioned and allocated under such rules and regulations as the department of revenue may prescribe."

It will be noted that the department did not directly make any change in the cost of manufacturing factor but in averaging the three factors divided by approximately 2.6 instead of the prescribed statutory 3. However, sec. 83.6, pages 330-331 of the department's Training Manual (Exhibit 11-10A) states that this weighting of the manufacturing factor in a situation where the taxpayer does not manufacture all the goods it sells can be done either by reducing the cost of manufacturing factor before dividing by 3, or by making an adjustment in the divisor figure of 3. There is set forth this illustration of the latter method:

Factor	Weight		Percent to Wisconsin		Weighted Percent to Wisconsin
Property	1	x	15.93%	=	15.93%
Cost of Manufacturing	.25	x	0%	=	0%
Sales	1	x	22.14%	=	22.14%
Totals	2.25				38.07%

Average Percentage = 38.07% ÷ 2.25 = 16.92%

Authorization of the above method of weighting manufacturing costs where the taxpayer manufactures but part of the goods it sells in Wisconsin is set forth in Article 602.5 of the department's Income Tax Regulations (Exhibit 11-13). These regulations were adopted many years ago and were withdrawn in 1942 (Tr. Vol. V, p. 157), but the department has continued to weight manufacturing costs by the method set forth in its Training Manual.

Exxon contends that it was unlawful for the department to use such adjusted apportionment formula because the statutory words of sec. 71.07(5), Stats., "under such rules and regulations as the department of revenue may prescribe" required the existence of published rules and regulations. In support of this contention Exxon's brief cites *Celon Co.* v. *Department of Taxation* (1955), 269 Wis. 372, 382-383, 69 N.W.2d 453, wherein the Supreme Court stated:

> "It is true that the respondent [the department] has been given authority to make rules and regulations. Our attention is called to none that it has made under such section [sec. 71.07(5)]. We have checked carefully all of its rules in the Wisconsin Red Book, Administrative Rules and Orders, published in 1950 and we can find none referring to this portion of the statute. It clearly is not applicable."

However, the *Celon* case was not concerned with a problem of weighting manufacturing costs but with a conten-

tion by the department that where either of the methods, separate accounting or apportionment, is used by the taxpayer, if it does not properly assign to the state of Wisconsin the income attributable to Wisconsin, the department has the discretion to prescribe what method shall be followed in order to arrive at the correct Wisconsin taxable income. Here, if the department had directly reduced the cost of manufacturing to reflect only the percentage thereof which represented products sold that had been refined or otherwise manufactured by Humble, no published rules or regulations would have been required under the wording of sec. 71.07(2)(b), Stats. The fact that the department accomplished the identical result by weighting the divisor figure of 3 should not be a decisive factor. Therefore the Court determines that the applicable provision of sec. 71.07(2)(b) applies which does not require published rules and regulations.

The department's reply brief cites *W. R. Arthur & Co.* v. *Department of Taxation* (1962), 18 Wis. 2d 225, 230-231, 118 N.W. 2d 168. However, that case dealt with the taxation of a motor carrier operating both in Wisconsin and out-of-state, and the department substituted for the three factors constituting the apportionment formula prescribed in sec. 71.07(2), Stats., gross receipts, revenue miles, and payroll. The taxpayer did not challenge use of the factors of revenue miles and payroll, but objected to use of the gross receipts factor. The opinion of the Supreme Court cited sec. Tax 2.45, 6 Wis. Adm. Code, which provided that in special cases not falling within the statutory formula it "will substitute in the place of some or all of the statutory apportionment factors such other factor or factors as will reasonably apportion to Wisconsin the business income properly assignable to Wisconsin"; and held the taxpayer did not meet its burden of proving that the formula adopted

unfairly apportioned its income in Wisconsin. Here, no reliance has been placed by the department on sec. Tax 2.45, 6 Wis. Adm. Code, which is a published rule or regulation, and, therefore, the Court fails to see that the holding in that case is pertinent to the issue here under consideration.

More to the point is that the Commission and its predecessor, the Wisconsin Board of Tax Appeals, approved the department's use of the weighting method of varying the statutory apportionment formula in *Kroger Company* v. *Wisconsin Department of Taxation* (1956), 4 WBTA 319, and in *Cooper's Inc.* v. *Wisconsin Department of Revenue* (1973), 9 WBTA 342.

On remand, it will be the duty of the Commission to determine whether the weighting apportionment formula here employed by the department was justified by the circumstances that Humble did not manufacture all of the products it sold in Wisconsin, and whether the formula as so weighted unfairly apportioned Humble's income in Wisconsin for the years at issue. In making such determination the Commission will keep in mind that the burden of proving that the formula adopted unfairly apportioned Humble's income in Wisconsin is on Exxon. *W. R. Arthur & Co.* v. *Department of Taxation*, supra, p. 232.

Let judgment be entered setting aside Finding of Fact Numbers 19, 21, and 23, and Conclusions of Law Numbers 3, 6, and 7, and the order portion of the Commission's decision here under review which ordered the department's action on Exxon's application for abatement to be modified in conformity to the Commission's findings and conclusions; and remanding the matter to the Commission for further proceedings consistent with this decision.

Dated this 31st day of January, 1977.

By the Court:

/s/ George R. Currie

Reserve Circuit Judge

APPENDIX C

STATE OF WISCONSIN
TAX APPEALS COMMISSION

EXXON CORPORATION, f/k/a Humble Oil and Refining Company,

Petitioner,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

DOCKET NO. I-3806

DECISION AND ORDER
(Drafted by Commissioner Timken)

The above-entitled matter having come on to be heard before this Commission; the petitioner, EXXON CORPORATION, f/k/a Humble Oil and Refining Company, having appeared by its Senior Vice-President, Oral L. Luper, and by its Tax Attorney, Robert E. Tannehill; and by its attorneys, Boardman, Suhr, Curry & Field, by Thomas G. Ragatz; and by its attorneys, McBride, Baker, Wienke & Schlosser, by Lloyd M. McBride and Paul D. Frenz; the respondent, WISCONSIN DEPARTMENT OF REVENUE, having appeared by its attorneys, Irving F. Shapiro and Robert M. Finley; and being fully advised in the premises, having considered the testimony, evidence and briefs of counsel, this Commission hereby finds and decides as:

FINDINGS OF FACT

1. The petitioner is a corporation organized under the laws of the State of Delaware with its general offices located in Houston, Texas.

2. During the years here under review, 1965 through 1968, Humble Oil and Refining Company was a wholly-owned subsidiary of Standard Oil Company of New Jersey. In early 1973, Humble Oil and Refining Company was merged into the parent company and the latter's name was changed to Exxon Corporation.

3. The three principal operating or functional departments of the petitioner are exploration and production, refining, and marketing, each organized into regional geographic divisions. The marketing department has nationwide jurisdiction and is headed by a vice-president located in Houston, Texas. Wisconsin is one of thirteen states in the central marketing region.

4. The petitioner's three principal operating departments, exploration and production, refining, and marketing, were organized and operated as separate segments and separate functional operations of the petitioner's total corporate enterprise.

5. During the years here under review, the petitioner's activity in Wisconsin was the marketing of refined petroleum products and automotive accessories. It had no exploration, production, or refining facilities located in Wisconsin.

6. During the period here under review, the petitioner carried on its marketing operations in Wisconsin primarily through service stations, terminals, and bulk storage facilities.

7. Pursuant to an exchange agreement between the petitioner and Pure Oil Company (a non-related company), gasoline and fuel oil were transported by the petitioner from Lemont, Illinois to its terminals in Wisconsin. Such products were sold by the petitioner in Wisconsin. None of the petitioner's own refined gasoline and fuel oil were sold in Wisconsin during the years 1965 through 1968.

8. Motor oils, greases, and other packaged products were, during the period here under review, produced and manufactured by the petitioner outside of Wisconsin and were shipped into Wisconsin for sale in Wisconsin from petitioner's central warehouse facilities in Chicago, Illinois and from other out-of-state locations.

9. During the period here under review, tires, batteries, and accessories were centrally purchased by the petitioner's purchasing office in Houston, Texas and were shipped from out-of-state locations into Wisconsin for sale.

10. The petitioner utilized internal transfer prices between its functional departments that were the equivalent of third-party competitive prices.

11. During the period here under review, the petitioner's exploration and production and refining departments had no operations or activities in the State of Wisconsin.

12. During the period here under review, the petitioner carried on centralized purchasing for all its operating divisions; and centralized advertising was directed from the home office in Houston, Texas on a uniform nation-wide basis.

13. During the period involved herein, key employees of the petitioner were transferred from one department to another as a method of employee training.

14. During the period involved herein, the petitioner used a uniform credit card system throughout the United States including Wisconsin.

15. During the period here under review, the petitioner utilized centralized accounting methods under the direction of its Houston home office.

16. During the period here under review, the petitioner had in effect a company-wide stock option and bonus plan, which included its Wisconsin operations.

17. During the period here under review, the petitioner's home office in Houston, Texas was responsible for and/or directed pricing policy, drafting of uniform selling forms and contracts, product guarantees or warranties, establishment of sales districts, negotiation and execution of exchange agreements, location of new service station outlets, approval of operating budgets, banking and investment of funds, utilization of legal services, preparation of federal and state tax reports, borrowing money, approval of salary increases and retirement plans, paid vacation plans, and health and accident insurance, all on a company-wide basis.

18. During the period involved herein, income derived from each of the petitioner's functional operating departments could be determined from the petitioner's books and records.

19. The petitioner's three main functional operating departments, exploration and production, marketing, and refining, were each unitary businesses.

20. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's exploration and production function.

21. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its exploration and production function.

22. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's refining function.

23. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its refining function.

24. During the period involved herein, the petitioner's Wisconsin marketing operations were an integral part of the petitioner's overall marketing function.

25. The petitioner filed Wisconsin corporation franchise or income tax returns for the calendar years 1965 through 1968 based on the separate accounting method of reporting its income to the State of Wisconsin. In said returns, losses were shown in the amounts of $821,320, $1,159,830, $1,026,224 and $919,575, respectively, for such years.

26. Under date of June 25, 1971, the respondent, Wisconsin Department of Revenue, issued a notice of assessment of additional income and franchise taxes against the petitioner, Exxon Corporation, covering the years 1965 through 1968.

27. In said assessment, the respondent determined that the petitioner realized additional net income in the amounts of $759,371, $1,043,395, $1,264,946, and $1,464,443 for the years 1965 through 1968, respectively, and computed additional Wisconsin franchise tax thereon totaling $316,-470.85.

28. The assessment here under review was based on a field audit of the petitioner's books and records conducted by the respondent covering the years here under review. In the course of said audit, the respondent determined that the petitioner's separate accounting method of reporting its income to the State of Wisconsin did not accurately reflect its Wisconsin taxable income. The respondent recomputed the petitioner's income/franchise tax liability on the three-factor apportionment basis provided for in Section 71.07 of the Wisconsin Statutes, and further weighted the cost-of-manufacturing factor in the formula it utilized.

29. Under date of July 21, 1971, the petitioner filed an application for abatement of the said additional assessment with the respondent.

30. Under date of November 30, 1971, the respondent denied the said application for abatement.

31. On December 30, 1971, the petitioner filed a petition for review with this Commission.

32. The apportionment formula utilized by the respondent had the effect of imposing a tax on the petitioner's exploration and production and on its refining net income, all of which was derived solely from operations outside the State of Wisconsin and which had no integral relationship to the petitioner's marketing operations within Wisconsin.

33. The respondent's taxation of net income from the petitioner's exploration, production and refining functions subjects the petitioner to multiple-state taxation as to such income.

34. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.

35. The petitioner's method of reporting its income to Wisconsin on a separate accounting basis did not accurately reflect its Wisconsin income.

WISCONSIN STATUTES INVOLVED

Section 71.01 Imposition of tax; exempt income.

"(2) FRANCHISE TAX ON CORPORATIONS. For the privilege of exercising its franchise or doing business in this state in a corporate capacity every domestic or foreign corporation, except corporations specified in sub. (3), shall annually pay a franchise tax according to or measured by its entire net income of the preceding income year at the rates set forth in s. 71.09 (2am). Every corporation organized under the laws of this state shall be deemed to be residing within this state for the purposes of this franchise tax.

All provisions of chs. 71 and 73 relating to net income taxation of corporations shall apply to franchise taxes imposed under this subsection, unless the context requires otherwise. * * *."

Section 71.07 Situs of income; allocation and apportionment.

"(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:

"(a) The ratio of the tangible property, real, personal and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere.

Cash on hand or in the bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be considered tangible property nor included in the apportionment. In determining apportionable net income with respect to the calendar year 1964 and corresponding fiscal years and thereafter, in any case in which the property factor is distorted by the taxpayer depreciating property in Wisconsin by a method different from that used to depreciate property outside Wisconsin, the department may determine the property factor by depreciating all property by the same method or using original cost or any other means as will achieve an equitable result.

"(b) In the case of persons engaged in manufacturing or in any form of collecting, assembling or processing goods and materials, the ratio of the total cost of manufacturing, collecting, assembling or processing within this state to the total cost of manufacturing, or assembling or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing', as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term shall be generally interpreted to include as elements of cost the following:

"1. The total cost of all goods, materials and supplies used in manufacturing, assembling or processing regardless of where purchased.

"2. The total wages and salaries paid or incurred during the income year in such manufacturing, assembling or processing activities.

"3. The total overhead or manufacturing burden properly assignable according to good accounting

practice to such manufacturing, assembling or processing activities.

"(c) In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year."

WISCONSIN ADMINISTRATIVE CODE INVOLVED

Rule TAX 2.42 provides in part:

"TAX 2.42 Apportionment method. (Section 71.07 (2), Wis. Stats.) Any person engaged in business within and without the state must report by the statutory apportionment method when the business of such person within the state is an integral part of a unitary business, unless the department of taxation expressly permits reporting on a different basis."

CONCLUSIONS OF LAW

1. The petitioner's income/franchise tax returns prepared on a separate accounting basis did not properly reflect the income taxable by the State of Wisconsin for the years in issue, as required by Section 71.07(2) of the Wisconsin Statutes.

2. The respondent's action was proper in refusing to permit the petitioner's separate accounting method of reporting its income for the years here in issue.

3. During the years in issue, the petitioner was operating a multi-state unitary marketing business within the intent and meaning of Section 71.07(2) of the Wisconsin Statutes, and the petitioner's Wisconsin marketing operation was an integral part thereof.

4. Under the provisions of Section 71.07(2) of the Wisconsin Statutes, it was mandatory for the petitioner

to use the apportionment method of reporting its income for Wisconsin franchise tax purposes.

5. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.

6. The apportionment formula used by the respondent in the audit and assessment here under review was improper in including income from petitioner's exploration, production and refining departments, and resulted in assessing a tax on extraterritorial income earned by the petitioner.

7. An apportionment formula, apportioning income earned by the petitioner from its marketing function within and without the State of Wisconsin, would be proper and within the intent and meaning of the statutory mandate contained in Section 71.07(2) of the Wisconsin Statutes.

Therefore,

IT IS ORDERED

That the respondent's action on the petitioner's application for abatement be and the same is hereby modified in conformity with the Findings and Conclusions contained above, and as modified, is affirmed.

Dated at Madison, Wisconsin, this 8th day of April, 1976.

WISCONSIN TAX APPEALS COMMISSION

R. J. Surz
R. J. Surz, Chairman
Thomas R. Timken
Thomas R. Timken, Commissioner
John P. Morris
John P. Morris, Commissioner

APPENDIX D

SUPREME COURT OF WISCONSIN

Wisconsin Department of Revenue,
Petitioner-Appellant,
and Cross-Respondent,

v.

Exxon Corporation,
Respondent and
Cross-Appellant.

Appeal No. 76-751

REMITTITUR

This cause was an appeal to review the judgment of the Circuit Court of Dane County. On consideration whereof, it is now here ordered and adjudged by this Court in an opinion filed on June 29, 1979, that the judgment of the Circuit Court of Dane County, in this cause is affirmed in part, reversed in part, and remanded for further proceedings consistent with this opinion.

The appeal record is hereby returned to the Clerk of Courts for Dane County.

I certify that the above is a correct transcript of the original order and judgment of the court in the above entitled cause.

Dated this 7th day of
August, 1979.

/s/ *Kay Wacker, Deputy*
Clerk of the Supreme Court of the State of Wisconsin

APPENDIX E

IN THE SUPREME COURT OF THE STATE OF WISCONSIN

EXXON CORPORATION,
Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

NO. 76-751

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that EXXON CORPORATION, Appellant, hereby appeals to the Supreme Court Of The United States from the final judgment (except for that portion labeled "Question #3," 90 Wis. 2d at 731, 281 N.W.2d at 111) of the Supreme Court of the State of Wisconsin affirming in part and reversing in part a judgment of the Circuit Court for Dane County, Wisconsin, which final judgment was entered in this proceeding on June 29, 1979.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

FOLEY & LARDNER

By: /s/ *Thomas G. Ragatz*
First Wisconsin Plaza
1 South Pinckney Street
Madison, Wisconsin 53701

DATED: September 21, 1979

STATE OF WISCONSIN)
) SS:
COUNTY OF DANE)

IN THE SUPREME COURT OF THE STATE OF WISCONSIN

EXXON CORPORATION,

Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

NO. 76-751

AFFIDAVIT OF FILING OF NOTICE OF APPEAL FILED WITH THE SUPREME COURT OF WISCONSIN, WISCONSIN CIRCUIT COURT, DANE COUNTY, AND WISCONSIN TAX APPEALS COMMISSION AND OF SERVICE ON ALL PARTIES

I, Russell Feingold, being duly sworn under oath, state that, on this date, I have personally filed a Notice of Appeal with the Clerk of the Supreme Court of Wisconsin and copies thereof with the Clerks of the Wisconsin Circuit Court, Dane County and the Wisconsin Tax Appeals Commission, and have personally served a copy of the Notice of Appeal on counsel of record for Appellee at the following addresses:

Attorney General, State of Wisconsin
State Capitol Building
Madison, Wisconsin 53703

Wisconsin Department of Revenue
201 East Washington Avenue
Madison, Wisconsin 53703.

I further state that all parties required to be served with the Notice of Appeal filed by Exxon Corporation with the Wisconsin Supreme Court, the Wisconsin Circuit Court, Dane County, and Wisconsin Tax Appeals Commission have been served.

I further state that this Proof of Service has been filed with the Clerk of the Supreme Court of Wisconsin concurrently with the filing therewith of the Notice of Appeal.

DATED: September 21, 1979.

/s/ *Russell Feingold*
Russell Feingold
Foley & Lardner
One South Pinckney Street
Madison, Wisconsin 53701

SUBSCRIBED AND SWORN TO
before me this 21st day
of September, 1979.

/s/ *Thomas G. Ragatz*
Thomas G. Ragatz
Notary Public

APPENDIX F

71.07 (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived.

APPENDIX G

71.07 (2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of revenue may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. * * *

APPENDIX H

WISCONSIN TAX APPEALS COMMISSION

HUMBLE OIL & REFINING COMPANY,

Petitioner,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

PETITION FOR REVIEW

Docket No. .....

To the Honorable Wisconsin Tax Appeals Commission:

COMES NOW Humble Oil & Refining Company (hereinafter called "Petitioner"), and hereby petitions for review of the Wisconsin Department of Revenue's (hereinafter called "Department") Notice of Denial of Application for Abatement dated November 30, 1971, and received December 3, 1971, a copy of which is attached hereto, and alleges as follows:

(1) *Petitioner.* Petitioner is a private corporation duly organized and existing under the laws of the State of Delaware, and is duly qualified to do business in the State of Wisconsin, having complied with all requirements of the laws of the State of Wisconsin. Petitioner's principal office is located at 800 Bell Avenue, Houston, Texas 77002.

(2) *Statement of Facts.* This petition involves Wisconsin corporation income and franchise taxes for the taxable years 1965-1968 inclusive. On June 25, 1971, the Department mailed to Petitioner a Notice of Additional In-

come and Franchise Taxes in the amount of $316,470.85, plus interest. Within thirty days thereafter, on July 21, 1971, Petitioner filed with the Department an Application for Abatement pursuant to Section 71.12, Wisconsin Statutes. Such Application was denied by the Department on November 30, 1971. This appeal is filed pursuant to and within the time prescribed by Section 73.01(5), Wisconsin Statutes. Petitioner denies that any additional income and franchise tax or interest was properly and legally determined, and denies that all or any portion thereof as thus determined is due and owing.

Petitioner is the successor to the Wisconsin properties and business of the Pate Oil Company of Milwaukee, Wisconsin, and during the period in question continued to operate such business as a separate and distinct entity. Its only business activity in the State of Wisconsin is the marketing of petroleum products and related accessories. All of Petitioner's activities in the State of Wisconsin have been and are treated as a separate unit, separately staffed and independent of and unrelated to Petitioner's activities carried on elsewhere.

Petitioner timely filed Wisconsin corporation income and franchise tax returns for the years 1965-1968, utilizing a direct accounting method for the reporting of its income from such independent Wisconsin activities pursuant to Section 71.07(2). The records from which these returns were prepared are maintained on a separate accounting basis. In the Department's assessment and Notice of Denial of Application for Abatement, the direct accounting method was disallowed, and the Department apportioned Petitioner's income under a method devised by the Department only for oil and gas companies.

(3) *Grounds for Objection.* Petitioner objects to the assessment of the alleged deficiencies on the following grounds:

(a) The Department's refusal to permit Petitioner to report the results of its separate Wisconsin unit on the basis of its separate accounting was arbitrary and capricious and denied Petitioner's right to use the separate accounting method under Section 71.07(2), Wisconsin Statutes, to clearly reflect its Wisconsin income.

(b) The Department, in disallowing the direct accounting method, failed to limit the imposition of the Wisconsin tax to Petitioner's income derived only from business transacted and property located within the State of Wisconsin as required and intended by Section 71.07(2), Wisconsin Statutes.

(c) Petitioner's business is not unitary in nature, and, consequently, its business in Wisconsin is not an integral part of a unitary business; and the Department's failure to impose the tax on an allocation and separate accounting method is arbitrary, capricious and illegal, and is in violation of the express provisions and intent of Section 71.07(2), Wisconsin Statutes.

(d) In the alternative, even if Petitioner's business were determined to be unitary in nature, its Wisconsin business is not an integral part of its unitary business, and the Department's failure to impose the tax on an allocation and separate accounting method is arbitrary, capricious and illegal, and is in violation of the express provisions and intent of Section 71.07(2), Wisconsin Statutes.

(e) In the alternative, regardless of whether or not it be determined that the Petitioner's business is unitary in nature and that the Petitioner's business in Wisconsin is an integral part of Petitioner's unitary business, nevertheless, the apportionment by the Department of income from Petitioner's oil and gas production operations is arbi-

trary, capricious and illegal, and is in violation of the express provisions and intent of Sections 71.07(1) and (2), Wisconsin Statutes.

(f) The Department's approach to the determination of Petitioner's income taxable in Wisconsin in effect attempts to impose a tax on activities outside the state which are independent of any of Petitioner's activities in Wisconsin, and to impose a tax upon income from real property located outside the state; such a construction of Section 71.07 would give it a breadth for which there is no basis under the Wisconsin Constitution, thus rendering the statute unconstitutional if so construed.

(g) As the result of the Department's method of determining Petitioner's net income under the Wisconsin Statutes, income from Petitioner's business, operations and properties outside the State of Wisconsin has been subjected to taxation in Wisconsin, all in violation of the due process clause of the Fourteenth Amendment to the United States Constitution, and which constitutes a burden on interstate commerce in violation of Article I, Section 8(3) of the Commerce Clause of the United States Constitution.

(4) *Petitioner's Representatives.* Authorized to appear and act for the Petitioner in relation to the matter here in issue are attorneys Thomas G. Ragatz, of Madison, and Lloyd M. McBride and Paul D. Frenz of Chicago, separate written authorization therefor being herewith submitted; and Attorney Robert E. Tannehill of Petitioner's legal staff. It is requested that all correspondence and other communications in connection with this matter be directed to Attorney Thomas G. Ragatz, P. O. Box 927, 110 East Main Street, Madison, Wisconsin 53701.

WHEREFORE, Petitioner prays that the decision of the Department denying its Application for Abatement be reversed and the deficiencies abated, and that an order be entered determining that Petitioner's reporting of its Wisconsin income for the years in issue on the basis of its separate accounting be affirmed; or in the alternative determining that Petitioner is entitled to deduct all its oil and gas production income as income following the situs of out-of-state property in determining the remaining income to be apportioned.

Respectfully submitted,

/s/ *Thomas G. Ragatz*
Thomas G. Ragatz
Attorney for Petitioner
P. O. Box 927
110 East Main Street
Madison, Wisconsin 53701

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Summary of Alternative Methods of Attributing Income to Wisconsin

Year	State's Hybrid Apportionment		Humble's Wisconsin Separate Accounting		Marketing Function Apportioned Only		Marketing & Refining Apportioned Only		Exploration And Production Separate Business or Allocation to Situs	
	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax
1965	$ 759,371	$ 52,961	($ 821,320)	$ -0-	$ 541,794	$ 37,731	$ 282,383	$ 19,572	$ 310,841	$ 21,564
1966	1,043,395	72,843	(1,159,830)	-0-	316,081	21,931	430,886	29,967	443,520	30,651
1967	1,264,946	88,351	(1,026,224)	-0-	394,993	27,455	490,252	34,123	503,182	35,028
1968	1,464,443	102,316	(919,575)	-0-	833,739	58,167	655,869	45,716	700,086	48,811
Totals	$4,532,155	$316,471	($3,926,949)	$ -0-	$2,086,607	$145,284	$1,859,390	$129,378	$1,957,629	$136,254
	(From Audit Report)		(From Wisconsin Returns)		(From Schedule D)		(From Schedule E)		(From Schedule C)	
Differences With State Audit And:										
a) Separate Accounting			$P,459,104	$316,471						
b) Marketing Apportioned Only					$2,445,548	$171,187				
c) Marketing And Refining Apportioned Only							$2,672,765	$187,093		
d) Exploration And Production As Separate Business Or Allocation To Situs									$2,574,526	$180,217

NOTE: This schedule summarizes the resulting Wisconsin net taxable income and franchise tax liability under four alternative conclusions as to the method for arriving at the net income attributable to Humble's activities in Wisconsin during the years 1965 thru 1968.

1) Separate accounting for Wisconsin marketing activities, as reported in Humble's Wisconsin tax returns.
2) Marketing functional department's net income allocated and apportioned to Wisconsin under the statutory formula, and all other income treated as from separate out-of-state businesses.
3) Marketing and Refining functional departments' combined net income allocated and apportioned to Wisconsin under the statutory formula; and all other income treated as from separate out-of-state businesses.
4) Exploration and Production function's net income treated as (a) a separate out-of-state business, or (b) as income from "mining" allocated to situs, with all other non-allocable net income of Humble apportioned under the statutory three-factor formula.

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APPENDIX I

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Comparison Of Net Income From Marketing Department With Assessed Income From Wisconsin Marketing Operations

Year	Wisconsin Sales[1]	Wisconsin Assessed Taxable Income[2]	Percent Of Net Income Per Dollar Of Sales	Total Marketing Sales[3]	Marketing Net Income - Wisconsin Basis[4]	Percent Of Net Income Per Dollar Of Sales
1965	$12,960,144	$ 759,371	5.9%	$1,985,040,274	$ 81,095,253	4.1%
1966	14,358,059	1,043,395	7.3%	2,115,810,678	48,751,718	2.3%
1967	16,350,330	1,264,946	7.7%	2,350,471,400	53,294,915	2.3%
1968	16,384,760	1,464,443	8.9%	2,512,855,906	105,601,885	4.2%
Totals	$60,073,293	$4,532,155	7.5%	$8,964,178,258	$288,743,771	3.2%

Notes:
1) From State Audit, Page 12 (Exhibit E-3) EXHIBIT # 1
2) From State Audit, Page 1 (Exhibit A-B) EXHIBIT # 1
3) From Petitioner's Schedule D, Page 2 EXHIBIT # 25
4) From Petitioner's Schedule D, Page 1 EXHIBIT # 24

*(Less allowable Federal income tax and contribution deductions.)

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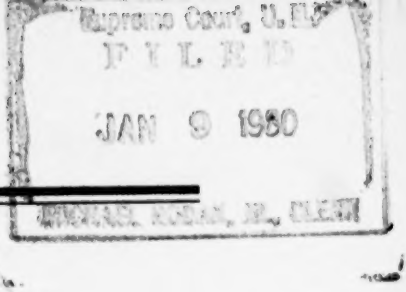

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-509

EXXON CORPORATION,

Appellant,

VS.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

UNITED STATES LAW PRINTING CO., CHICAGO, ILLINOIS 60618 (312) 525-6581

Jurisdictional Statement Filed September 26, 1979

Probable Jurisdiction Noted November 26, 1979

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The following decisions, statutory references, petition and exhibit have been omitted in printing this appendix because they appear on the following pages in the appendix to the printed Jurisdictional Statement:

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In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-509

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

APPENDIX (VOL. I)

APPENDIX

WISCONSIN TAX

STATE OF WISCONSIN APPEALS COMMISSION

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),

Petitioner,

- vs - Docket No. I-3806

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

Transcript of Proceedings in the above-entitled matter held before the Wisconsin Tax Appeals Commission, in Room 229, City-County Building, Madison, Wisconsin, on the 2nd day of October, 1974, commencing at 10:25 in the forenoon.

Presiding: R. J. Smrz, Chairman
Thomas R. Timken, Member
John P. Morris, Member

Also Present: Jay C. Gitchell, Hearing Examiner

APPEARANCES

Boardman, Suhr, Curry & Field, Attorneys at Law, 131 West Wilson Street, Madison, Wisconsin, by Thomas G. Ragatz,

and

McBride, Baker, Wienke & Schlosser, Attorneys at Law, 110 North Wacker Drive, Chicago, Illinois, by Lloyd M. McBride and Paul D. Frenz,

and

Robert E. Tannehill, Tax Attorney, Exxon Company, Houston, Texas, appearing on behalf of Petitioner.
Irving F. Shapiro and Robert M. Finley, Tax Counsel, Wisconsin Department of Revenue, 201 East Washington Avenue, Madison, Wisconsin, appearing on behalf of Respondent.

Mr. Timken: We will call for a hearing in the matter of Exxon Corporation, Petitioner, versus Wisconsin Department of Revenue, Respondent, Docket I-3806.

Will you give the appearances, please?

Mr. Ragatz: For the petitioner, Attorney Thomas G. Ragatz of Boardman, Suhr, Curry and Field in Madison. Also appearing for the petitioner are Attorneys Lloyd McBride and Paul Frenz of McBride, Baker, Wienke & Schlosser from Chicago, and Attorney Robert Tannehill of Exxon, Houston, Texas.

Mr. Shapiro: For the respondent, Irving F. Shapiro and Robert M. Finley.

Mr. Timken: You may proceed, Mr. Shapiro. Mr. Ragatz, do we have a corporate officer present or has that been waived?

Mr. Ragatz: I believe at pretrial I advised the Commission and the counsel for the Department that we would have a corporate officer here tomorrow, and counsel for

the Department indicated that they would not object to that procedure. He will be here to testify and he will be available for cross-examination.

Mr. Timken: Very well. Mr. Shapiro, you may proceed.

Mr. Shapiro: Sir, the usual practice of the Commission is to have the respondent offer the so-called jurisdictional exhibits at this time, and following that the petitioner proceeds with its case. Since the jurisdictional exhibits have been incorporated into the documents that have been stipulated to, I am requesting—and the stipulation has been entered into the record as Exhibit 15, I am wondering whether it is appropriate for the respondent to proceed any further at this time.

Mr. Timken: Mr. Ragatz, would you like to proceed?

Mr. Ragatz: As counsel for respondent has indicated, we have stipulated to the admission of, I believe it is now 15 categories of documents, one category having about another 15 sub-numbers, so there are approximately 30 documents that are already stipulated in, well, many more documents because there are working papers and very numerous documents in there and they are entered as one exhibit.

It might be worthwhile for us to read in at least the factual parts of the stipulation at this time before I proceed with the opening statement just to give you a little factual background and to accomplish what we hope would be a saving of time by preparing this stipulation.

I may say initially that the documents we have stipulated into evidence per the stipulation shall be stipulated into evidence in this action and made part of the record for purposes of all hearings, trials and appeals in this cause, to provide undisputed evidence of the authenticity, existence and contents of such documents with the reservation that each party reserves the right to argue the relevance of any data contained in the documents, and I am assuming such arguments would be made in brief after the hearing and would not take up the time now.

As I say, we have enumerated roughly 30 documents, and pursuant to the stipulation I would like to move the admission of these documents set forth in the stipulation and the stipulation itself into evidence at this time to be formally made part of the record.

Mr. Timken: Do we have that stipulation before us? Mr. Shapiro, any objection?

Mr. Shapiro: No objection.

Mr. Timken: Very well, the stipulation is accepted and the exhibits contained therein are accepted and received into the record.

Mr. Ragatz: In connection with the stipulation I would further note that the exhibits numbered 7, 8, 9 and 10 constitute the discovery transcripts of four employees of the Department of Revenue, and you will recall that the Commission granted the petitioner discovery authority and that we took these depositions back in January. Now to save time at this proceeding, we have agreed with counsel for the Department of Revenue that these discovery transcripts would be as exhibits and part of the record and that the testimony given therein is part of the record for purposes of this case.

Now because of this we can avoid covering a lot of ground the second time. However, for the Commission to get the full understanding of the evidence, you will have to examine those exhibits, and we will highlight at least some of that testimony to try to give you continuity to the picture as we present the case.

Now I would like to read for the record the facts that have been stipulated and the basis of this stipulation is that counsel have agreed for purposes of this action only to the truth of the following facts and to the admissibility of this stipulation into evidence in this action for use in all the hearings, trials and appeals in this case, for the purpose of providing undisputed evidence of such facts.

(1.) Petitioner timely filed its Wisconsin corporation income and franchise tax returns for the calendar tax years of 1965 to 1968, both inclusive. The returns were prepared and the computations made on the separate accounting method. Losses were shown in the amounts of $821,320; $1,159,830; $1,026,224; and $919,575, respectively, for the years 1965, 1966, 1967 and 1968, aggregating $3,926,949 for the four year period. No tax was shown as being due for any such year.

(2.) Under date of June 25, 1971, C. J. Hoel, Section Chief of the Respondent, forwarded to Petitioner a Notice of Assessment of Additional Income and Franchise Tax (Exhibit 1), to which there was appended the Franchise Tax Audit Report (the "Audit Report") of Mr. Thomas J. Sheridan dated May 1, 1971, in which he found that Petitioner's income was subject to apportionment, which subjected it to tax on or measured by additional income of $4,532,155 for the period 1965 through 1968. Additional taxes in the amount of $316,470.85 were thereby assessed against Petitioner. These documents were received by Petitioner on June 28, 1971.

(3.) Under date of July 21, 1971, Petitioner timely filed an Application for Abatement (Exhibit 3). On October 26, 1971, an informal conference was held on the Application in the offices of the Respondent at Madison, Wisconsin.

(4.) Under date of November 30, 1971, C. J. Hoel, forwarded to Petitioner a Notice of Denial of Application for Abatement (Exhibit 4), to which there was appended a Notice of Additional Taxes Due, dated November 30, 1971, in the principal amount of $316,470.85, plus interest.

(5.) On December 30, 1971, Petitioner timely filed a Petition for Review by the Commission (Exhibit 5), and subsequently Respondent timely served and filed its Answer (Exhibit 6).

(6.) Petitioner subsequently made an application for discovery authorization, which the Commission granted on May 26, 1973; and the discovery examinations of four employees of the Respondent were conducted on January 15 and 16, 1974 and the transcripts of such examinations were Exhibits 7 through 10 herein. Pursuant to a Subpoena Duces Tecum served upon Respondent by stipulation with its counsel, Respondent produced the documents sub-numbered under Exhibit 11 herein and others, indicating that such documents constitute all documents known to Respondent covered by the enumerated categories in the Subpoena and pertinent to the audit and assessment of the Petitioner for the 1965-1968 period of the audit in issue and for the 1960-1964 period of the prior audit, with the exception of documents referred to as the "Continental Oil Co. work papers" which were used as a model for the audit of the Petitioner but which Respondent refused to produce and which refusal was upheld by the Commission.

(7.) Respondent had also audited the Petitioner for the period 1960 through 1964, which audit was conducted for Respondent by Kurt Kaspar, Jr. The Notice of Assessment and Audit Report for that period is Exhibit 2 herein.

(8.) Petitioner Exxon Corporation (hereinafter "Exxon") was formerly named Standard Oil Company of New Jersey (hereinafter "SONJ") which prior to the name change in early 1973 was the owner of a wholly owned subsidiary corporation named Humble Oil & Refining Company (hereinafter referred to as "Humble"). At about the time of the name change Humble was merged into Exxon, making Exxon the legal successor to the original Petitioner in this action.

(9.) In 1956 SONJ organized as a wholly owned subsidiary a Delaware corporation named Pate Oil Company, which then acquired all of the assets and liabilities of Saxon Corporation, a Wisconsin corporation whose name

had just been changed from Pate Oil Company. The new Pate Oil Company continued the operations of the former company under the name "Pate," which operations were all located in Wisconsin and consisted of the marketing of petroleum products and accessory products. Corporate income tax reporting to the State of Wisconsin was done on the basis of the results of the new corporation's Wisconsin marketing operations, which continued the pattern of the former Pate corporation in reporting all of its income to Wisconsin.

(10.) On June 30, 1960 SONJ caused (new) Pate to be merged into Humble, and thereafter the Wisconsin marketing operations were continued by Humble with the brand name being changed to "Enco." In early 1973 Humble was merged into SONJ and the latter's name changed to Exxon. Petitioner will be referred to in this case as either "Exxon" or "Humble," and such references are intended, unless otherwise specified, to refer to the legal entity which conducted the Wisconsin operations, named Humble Oil & Refining Company, to which Exxon is now the legal successor.

That concludes the stipulation. And now, unless you would like something different, I will proceed with the opening statement.

Mr. Timken: You may proceed.

Mr. Ragatz: May it please the Commission: we are here today to present the case of petitioner, Exxon Corporation, in connection with its petition requesting reversal of the Wisconsin Department of Revenue's denial of an application for abatement of corporate franchise taxes assessed for the years 1965 through 1968.

Initially, I would like to point out as the stipulation already does that the name of the petitioner during the years in issue was Humble Oil and Refining Company and that we will undoubtedly, through our witnesses, be referring

to the petitioner on occasion by Exxon, but most of the time by the name of Humble. But these are one and the same entity in that Exxon is the legal successor by merger to Humble.

And, incidentally, one of the jurisdictional exhibits relating to the petition is amedment to the original petition changing the name from Humble to Exxon.

Now during the years in issue Humble was engaged in the major domestic operations of exploring for, producing, refining, transporting and marketing oil and gas and related petroleum products. Because of legal reasons it operated these service stations all over the country under various names. In Wisconsin the brand name used was "Enco" and in fact that same brand name is still in use here in Wisconsin today despite the fact that the Exxon brand name has been implemented elsewhere.

For reasons related to the facts here in issue, Exxon has not seen fit to change the name of its Wisconsin operations. One of the witnesses will elaborate on this further.

The evidence will show that Humble was organized on a functionally independent basis, and that its separate functions were operated as separate businesses in competition with other oil companies have similar functions and other companies which only operated in the business activity of a particular function.

We intend to develop through the evidence the functional independence of the various departments, and we ask the Commission to pay particular attention to this aspect of the case.

The key functional departments which will be discussed in evidence are Exploration and Production, frequently referred to as E and P, the refining function and the marketing function. Now while there are other functional departments such as marine, land management, minerals and coal and shale oil, the results of the operations by these depart-

ments are largely situs oriented and although respondent included them for the most part in apportionable income on its audit, we believe that at least since the discovery examination it should recognize that the income of such functional departments is properly allocable to situs.

For purposes of this hearing we will concentrate on the functional operation of the three major functional departments, that is, exploration and production, refining, and marketing.

The evidence will disclose that Humble conducted no exploration or production activities of any nature in Wisconsin, and that no refining activities were conducted in Wisconsin either. In fact, the only activities in which the petitioner was engaged in Wisconsin during the years in issue, and since, was a relatively small amount of marketing. The marketing operations in Wisconsin are a carryover of the Pate Oil Company which Standard Oil of New Jersey acquired in 1956 and operated as a separate corporation until 1960. Pate was an independent marketer, and after the merger of Pate into Humble in 1960 Humble continued the same Wisconsin marketing operations, which Pate had been conducting.

Humble has always reported for Wisconsin income tax purposes on the basis of separate accounting, and during the years in issue it showed substantial losses arising from its Wisconsin marketing operations. Such losses aggregated over $3,900,000 during the years in issue. The respondent, however, employed a hybrid version of the statutory apportionment formula, and reached the conclusion that the petitioner had substantial taxable income during each of the years of issue. Such taxable income totaled over $4,500,000 for the four years, which figure we think the Commission should particularly note because it is approximately $8,460,000 higher than the results shown by the petitioner's separate accounting. This very significant

difference is important not only because of the dollar impact on the petitioner, which we submit is way out of proportion to its marketing activities within this state, but also because it represents a drastically different result than the respondent could conceivably justify on any assessment based upon the principles of separate accounting.

Therefore, it is our position that by use of the apportionment formula respondent is attempting to reach and subject to Wisconsin tax income from non-Wisconsin independent functional operations which have no rational connection or nexus to petitioner's activities in the State of Wisconsin, principally exploration and production income.

We contend that such treatment constitutes both a violation of due process and a burden on interstate commerce. In addition, respondent has attempted to reach even further by aborting the statutory formula to drag in even more income to subject to tax. This aborted formula will be referred to by the petitioner as a "hybrid formula," and we contend that this hybrid constitutes an extension of the "over reach" of the apportionment formula itself. Furthermore, we feel the evidence will also show that the respondent's application of the apportionment formula subjects the petitioner to the risk of multiple state taxation; and we contend that this risk of multiple taxation is not only burdensome to the petitioner, but that it constitutes a constitutionally impermissible burden on interstate commerce in violation of the commerce clause of the United States Constitution.

Our evidence in connection with petitioner's exploration and production function will demonstrate that it is organized and run as a separate business, and that the petitioner's corporate policy of functional profitability independence is carried out by the sale of a substantial portion of the crude oil to third parties at third party prices known as "posted field prices," and by the transfer of other crude

to the petitioner's refining department also at the posted field prices.

The use of such prices for crude oil and similarly determined prices for natural gas, which prices are determined in each field in relation to arms length conditions, and which the evidence will show are recognized as third party prices, establishes the integrity of the internal accounting for the net income of the exploration and production function; and the respondent has recognized the integrity of this net income determination in its own unpublished policies disclosed on discovery, and also has recognized this integrity by utilizing Humble's exploration and production net income figure as one of the base figures in its calculation of the portion of petitioner's exploration and production income which respondent deems apportionable.

The same functional profitability independence policy applies to the refining function, in that it acquires crude from outsiders and from petitioner's exploration and production function at posted field prices, and it sells and transfers the refined product to third parties at negotiated arm's length prices, and to petitioner's marketing department at such third party prices determined in relation to those published in the accepted industry publication known as Platt's Oilgram.

Because of the integrity of the internal accounting for functional profits, the fact that each function stands alone and deals with other functions on the same basis as it deals with third parties, and the highly significant fact that no oil or gas from petitioner's exploration and production function comes into the State of Wisconsin to be sold as fuel oil, heating oil or gasoline, it should be clear that petitioner's refining and exploration and production functions are not integral parts of petitioner's marketing operations in Wisconsin.

On this factual background it should be clear that the respondent cannot by apportionment pull into Wisconsin for tax purposes a portion of petitioner's exploration and production or refining net income, thus creating Wisconsin taxable income way out of proportion to the possible profitability results of Wisconsin marketing operations. An authorization to use the apportionment method certainly cannot be taken as a blank check to pull in and tax income that has no relationship to the taxing state.

Respondent contends that its use of apportionment is authorized by Section 71.07 (1) of the Statutes. The audit letter which accompanied the assessment in issue states the conclusion that petitioner "is an integrated oil company" and that since petitioner "is a unitary company and its Wisconsin business is an integral part thereof, formula apportionment of the company's income is mandatory and separate accounting is not permissible."

The evidence will demonstrate, however, just as the discovery proceeding has already demonstrated, that the respondent's audit made no real attempt to determine whether or not petitioner's business was unitary or whether its Wisconsin business was an integral part of a unitary business. Respondent's definition of "unitary," as expressed in its unpublished policy papers, and on discovery by its personnel involved with the audits of petitioner, demonstrate that respondent would treat any corporation with multi-state operations as a unitary business. Respondent's record would indicate that this is the interpretation it follows.

We submit, and suggest that the evidence will demonstrate, that the definitions used are so imprecise as to be of no value; and that respondent's over reaching interpretation does not conform to the language of the statute. The requirement that the business done in Wisconsin must be an integral part of a unitary business obviously does not

apply where a taxpayer has separate functionally independent out-of-state busineses which are neither necessary to nor dependent upon the Wisconsin operations.

Our evidence will show that none of petitioner's functional departments are integral parts of a unitary business composed of all functions combined; rather it will show that each function is independent and not unitary to or an integral part of any other function.

Respondent's deficiency assessment included approximately 40% of the exploration and production department income in apportionable income by the use of a barrel formula as part of the hybrid apportionment formula. Thus, it treated approximately 60% of the production income as allocable to the situs of the producing states. We contend that 100% should have been so allocated, or treated as income from an out-of-state business, so that no portion of income from the exploration and production business is includable in Wisconsin apportionable income, and that to include any portion would be in violation of the due process and commerce clauses of the U.S. Constitution.

Apportionment certainly is not a blank check authorizing the taxation of income that has no rational relationship to Wisconsin.

We contend that Section 71.07 of the Statutes limits the imposition of the tax in the case of corporations deriving income from within and without Wisconsin, so that only income from business transacted and property located within the State can be taxed.

We contend that the proper construction of this statute requires that each activity of the petitioner which is of substantial separateness from each other activity, must be regarded as a business, and that the statute must be applied to each such business separately. As already mentioned, the only business conducted within the State was marketing, and to include any part of the income derived

from production business and properties in apportionable income would be to unconstitutionally tax extraterritorial income. If Section 71.07 were construed so as to tax such income, it would clearly be unconstitutional, and the application of the presumption of constitutionality dictates that such a construction should not be adopted.

The exploration and production function, we contend, is not only a separate business which is not an integral part of the marketing activities of the petitioner in Wisconsin, but all its income is also properly classifiable as income allocable to situs from the operation of a mine or quarry within the meaning of Section 71.07 (1), which has been consistently construed by the respondent to include oil and gas income in the category of income from mining.

Since the statute requires the allocation of situs income before an apportionment formula can be utilized, and since the separately determined Exploration & Production function income constitutes income from a situs operation, whether or not the crude and gas is transferred to Petitioner's Refining function, we contend that the proper construction of the statute would be to in any event allocate all Exploration & Production income to situs.

Since there is no "integral" relationship between Petitioner's Exploration & Production function and its business in the State of Wisconsin, or between its Refining function and its business in the State of Wisconsin, the only possible question is whether there may be an integral relationship between the Petitioner's marketing function and its activities in the State of Wisconsin. While we acknowledge that this may be a closer question, we believe that the acquisition of third party product at industry prices determined in relation to Platt's Oilgram, the conduct of the Wisconsin marketing operations from a district office in Milwaukee, and the pattern whereby the Wisconsin marketing was the mere continuation of the business

of a separate corporation which originally did business as Pate Oil Company before the business was acquired, should support the conclusion that Wisconsin operations were not even an integral part of the Petitioner's Marketing function.

This leaves the question as to whether petitioner's separate accounting for Wisconsin marketing operations fairly reflects the results of its operations in this State. Respondent's auditors have already admitted under oath on the discovery proceeding that they have no basis to challenge Petitioner's separate accounting reporting of Wisconsin sales and of the related Wisconsin cost of sales; and that only a few operating expenses might be questioned as possibly relating to more than mere Wisconsin activities, although it was pointed out that even to reduce such expenses in half would not put the petitioner in a profit position in Wisconsin during any of the years in issue. Thus, we submit that the evidence will demonstrate that even giving respondent the benefit of the doubt on such expenses, a separate accounting calculation will not generate one cent of taxable income in Wisconsin during the years in issue.

As the Commission may recall from our Application for Discovery Authority, there are other deficiencies in the respondent's case relating to its use of a hybrid method employing a weighing factor not authorized by the statute, which permits use of other than the three factor statutory formula only when rules and regulations are prescribed as to such a hybrid method. No such rules have been prescribed. We intend to concentrate our efforts during the hearing on demonstrating the incorrectness of Respondent's position in denying use of separate accounting and requiring apportionment which subjects to Wisconsin taxation petitioner's refining and exploration & production functions. It is our intention, however, to preserve the question of whether respondent can refuse to make avail-

able the working papers it admittedly used as a model for the audit of the petitioner, having admittedly not prescribed and published any rules and regulations explaining its method; and to preserve the equal protection question as to whether the respondent must respond to inquiry as to whether other oil companies are being afforded the same or similar treatment, and allowing the petitioner to examine departmental witnesses on apparent inconsistencies in filed cases with other oil companies. In determining to concentrate during the hearing on the constitutional and statutory issues raised, petitioner has determined, despite the considerable complexity of respondent's apportionment calculations, and the possible deficiencies in the mechanics of such calculations, that it will not take the Commission's time to explore in depth the mechanics of the calculation; but rather after demonstrating certain arbitrary and erroneous assumptions used, we will concentrate on the issue of whether the apportionment method can be applied generally to petitioner's overall operations.

We will present as an exhibit a calculation showing possible Wisconsin taxable income or loss under certain possible alternative conclusions, which include: (1) separate accounting for Wisconsin marketing operations, (2) apportioning and taxing only petitioner's marketing function, (3) apportioning and taxing only petitioner's marketing and refining functions, and (4) treating petitioner's exploration & production function as a separate non-Wisconsin business or as income allocable to situs.

Before closing I want to highlight for the Commission what we view to be the overriding issues for determination:

1st. Does Section 71.07 of the Statutes permit the respondent to refuse to accept the petitioner's unchallenged separate accounting results for its Wisconsin operations, and impose upon it the apportionment method as to some or all its income from functionally independent depart-

ments? That is, are some or all of petitioner's functional departments unitary business and are its Wisconsin marketing functions an integral part of any such unitary business?

2nd. Even if the respondent is deemed authorized to use the apportionment method, can it be applied to operations which are functionally independent or to income which is clearly derived from situs operations, both of which have no connection to Wisconsin marketing operations.

3rd. Does an authorization to use apportionment allow the respondent to apply it in such a manner as to subject millions of dollars to Wisconsin taxation that have no rationale relationship to the marketing operations in this State and are way out of proportion to any possible profit potential of this Wisconsin marketing business?

Because of the precedential importance of the issues in this case, and the legal and factual complexity, I strongly urge each member of the Commission to make every effort to be present at all session of this hearing. In order to properly assimilate the evidence we submit, it will be very helpful to hear all of it in logical sequence and to examine the exhibits. We will be presenting significant constitutional issues for the Commission's determination, and I submit that the Commission will not be able to adequately decide this case without coming to grips with these constitutional issues. I urge the Commission not to duck these issues, and to accept the responsibility vested in it by making decisions on the constitutional questions. Otherwise the outcome will not be meaningful for either the petitioner or the respondent as to the basic issues.

Because of the complexity of this case I have dealt at some length in this opening statement, with both the factual background and with an identification of the issues and theories to be presented by the petitioner, in the hope that it will help the Commission to more quickly grasp the key

aspects of the evidence to be presented, and will give it a better initial perspective to view the serious constitutional issues.

Closing, I would like to say that the facts which we will present in our view will present a classic case of "over reach" and I trust that after you have assimilated the factual situation and reviewed the law, you will agree that the State's assessment and procedures have far exceeded the bounds of fair play and substantial justice required by the constitution.

Thank you.

Mr. Timken: Back on the record.

Mr. Shapiro, you may respond.

Mr. Shapiro: May it please the Commission, respondent prefers not to deal at length in its remarks by way of opening statement, but to reserve for the judgment of this Commission that it views all of the evidence, and I underscore the word "evidence" produced in the course of the hearing and that it considers the arguments made in brief by counsel for the parties after all of the evidence is in.

The basic question in this case is whether the operations of Humble within and without Wisconsin during the years 1965 through 1968 were unitary.

It is our contention that they were unitary under the established meaning of that term as used in the field of franchise and income taxation, and that accordingly, the petitioner was required to report its income to Wisconsin pursuant to the statutory apportionment method as prescribed by Section 71.07 (2) of the Statute and as amended by Chapter 171 of the Laws of 1949.

The franchise and income tax assessment of which the petitioner complains in this appeal resulted primarily from the fact that the respondent disallowed the petitioner's separate accounting for Wisconsin income and determined

Wisconsin's income by the apportionment method. The respondent has treated income derived from the sales of the company's produced crude oil to outsiders as nonapportionable or nontaxable income.

This income is excluded from the apportionment formula. This exclusion of income, we submit, is based upon the provisions of Section 71.07 (1) relating to income from the operation of a farm, mine or quarry, to the extent that the company's crude oil was refined and marketed by the company by virtue of exchange agreements or otherwise, the respondent included the income therefrom in the statutory apportionment formula applicable to a unitary business.

When it filed its Wisconsin franchise and income tax return, the petitioner reported net losses for each of the years in question. However, it earned net profit of $2,-200,000,000 from its total company operations during the audit period as disclosed in the returns in the record.

Counsel repeatedly refers to our apportionment method as a hybrid method. I submit that a better adjective would be statutory apportionment method and respondent will show, we submit, that the net income attributed to this State is not at all disapportionate to its total net income earned from its total United States operations.

We also submit that the record will disclose no impairment of the petitioner's constitutional rights. Counsel for the petitioner has made inferences and statements that are erroneous. We prefer not to go into that at this time, but to leave that for the evidence, as we will subsequently present.

We submit, in conclusion, gentlemen, that the assessment of this company from its operations stemming from the oil well to the pump represents a fair assessment of net income attributable to this State.

Mr. Timken: Thank you, gentlemen.

Mr. Ragatz, you may call your first witness.

Mr. Ragatz: The petitioner calls Thomas Sheridan adversely.

Mr. Shapiro: Gentlemen, may I interject at this time that the respondents will enter an objection to the calling of one of our auditors adversely. The parties have been notified by the Commission through its letter dated September 6, 1974 that calling witnesses adversely by either party was appropriate and within the ambit of proper procedure.

If the Commission permits that procedure now, the respondent wishes to point out that the prior decision of this Commission in John H. Verdev, recorded at 7 WTAC on Page 102, 108 is being reversed. This is the reversal of a long-standing policy of the Commission which facilitated an orderly presentation of the taxpayer's position first, and also provided an opportunity for cross-examination of the Department auditors.

The respondent will accordingly enter its objection for the record and it is requested that the Commission's letter of September 6, 1974 be made a part of this record. Can I do so?

(Exhibit Number 16 marked for identification)

Mr. Timken: Mr. Ragatz, any objection?

Mr. Ragatz: No objection.

Mr. Timkin: Does that conclude your statement?

Mr. Shapiro: Yes.

Mr. Timken: Exhibit 16 is received. I would inform Mr. Shapiro that your objection is overruled and we will allow the calling of witnesses adversely, and we do recognize that this is changing a longstanding policy of this Commission, but that all three members met and deliberated and unanimously agreed that that policy should be changed.

Your objection will be noted for the record, however. Mr. Sheridan will come forward.

Mr. Morris: Before the first witness is sworn, I would say that I would request a five-minute period of time in which to review that and the motion requesting that the witness be called adversely for the record purposes. May I have five minutes?

Mr. Timken: Yes, of course.

(Recess)

Mr. Timken: Back on the record.

Mr. Morris: Mr. Chairman, Members of the Commission, I would move this Commission to grant the motion of counsel for the petitioner in allowing the witness to be called adversely at this time.

The Chairman: I second the motion.

Mr. Timken: All in favor say "aye". (Ayes voiced) All opposed? (No response)

Motion unanimously carried. Your objection is noted, Mr. Shapiro.

THOMAS JAMES SHERIDAN, called as a witness, having been duly sworn under oath, testified as follows:

Direct Examination by Mr. Ragatz.

Q. State your full name for the record.
A. Thomas James Sheridan.
Q. Where do you live, Mr. Sheridan?
A. EauClaire, Wisconsin.
Q. How old are you?
A. Thirty-eight.
Q. What is your occupation?
A. I am an accountant.
Q. And why whom are you employed?
A. Wisconsin Department of Revenue.
Q. What is your position?
A. Field auditor.
Q. How long have you held this position?
A. Eleven years.

Q. Is that the only position you have held with the Wisconsin Department of Revenue?

A. No.

Q. Would you please describe your employment history with the Wisconsin Department of Revenue?

A. I started with the Wisconsin Department of Revenue in June of 1962, I worked in the Individual Section from June to March of '73—or '63—and in March of '63 I started with the Corporation Section.

Q. And you have been a field auditor for the Corporation Section ever since?

A. Yes.

Q. What is your educational background?

A. I have a Bachelor's of Business Administration Degree from the University of Iowa.

Q. What was your approximate average?

A. C.

Q. Did you have any economic courses, courses in economics?

A. Yes.

Q. Anything other than the basic required course?

A. No.

Q. Have you had any other courses in economics since college?

A. No.

Q. Have you attended any seminars on economics?

A. No.

Q. If I remember correctly from the discovery proceeding, you are now a CPA?

A. No.

Q. You are not? You have not sat for the examination?

A. I have since that hearing.

Q. But you have not passed the examination?

A. Correct.

Q. Now, what year did you graduate from college?

A. 1962.

Q. And was your first employment after college with the Wisconsin Department of Revenue?

A. Yes.

Q. Have you had any other accounting-related experience except through your employment with the Wisconsin Department of Revenue?

A. No.

Q. You were the auditor who audited Humble Oil and Refining Company for the years 1965 through 1968?

A. Yes.

Q. And when was this audit commenced?

A. January or February of 1970, I believe.

Q. And when was the audit completed?

A. I believe my letter is dated May of '71.

Q. Do you recall in the aggregate how many weeks you spent in Houston, Texas, in connection with this audit.

A. I would say three or four.

Q. Prior to this audit have you conducted any other audits of oil and gas companies?

A. No.

Q. Have you had any prior oil and gas accounting experience?

A. No.

Q. Have you had any prior oil and gas accounting training?

A. No.

Q. Now if I remember from the discovery, you indicated that subsequent to the audit of Humble you audited four other oil companies?

A. Yes.

Q. Now on the discovery examination you refused to identify them. Do you still refuse?

A. Yes.

Q. What is the basis of your refusal?

A. Privileged under the statutes.

Q. Do you have a statute in mind?

A. I believe it is 71 (11).

Q. That didn't sound like a complete statute number. Do you want to give that again.

A. Section 71.11.

Q. Now as to each of these four companies, do you still refuse to describe the basis on which they reported their Wisconsin income?

A. Yes.

Q. And do you still refuse to describe the basis on which you assessed them?

A. Yes.

Q. And do you still to refuse to produce the copies of those audit reports for our examination?

A. Yes.

Q. On discovery I also asked you whether you were familier with any oil companies that report for Wisconsin corporation franchise tax purposes on a separate accounting basis for any of their functions, such as E and P refining and marketing? Will you now answer that question?

A. May I have the question again?

(Question read)

A. May I see the statutes now, please? (Witness refers to statute book)

Mr. Shapiro: Gentlemen, the information elicited from the auditor touches on secrecy law and that is what he is concerned about, and his reluctance is understandable, and I submit that under that secrecy provision the auditor should not be required to go into the factual matters of any other company that was audited.

Mr. Morris: Mr. Chairman, just a question of Mr. Shapiro. Mr. Shapiro, if the auditing of a tax return is the

basis for a model of the auditing of this action before us today, how then will we receive the information that would be necessary to base—or how the Department based its assessments on such—in other words, you usually have rules, rules that you follow, and if these rules are not part of an auditing function of another taxpayer, how do we find this out?

Mr. Shapiro: Mr. Commissioner, we submit that if an audit of another taxpayer—working papers of another taxpayer may have been used to pattern some similar procedures in connection with the current audit, that does not in anyway constitute a rule. The standard auditing procedure as disclosed in the discovery is for an auditor to usually have the work papers of the same company for a preceding period when he is auditing that company, and this—as the record will disclose, Mr. Sheridan had the preceding work papers in his possession for Humble Oil Company, and that is what he used as the basis for his audit.

Mr. Morris: Are you saying then that another taxpayer—on the assessment of another taxpayer it does not play any role in the assessment of this taxpayer?

Mr. Shapiro: It is hard to categorically say. Our process must be uniform, and we make every attempt to make our auditing procedures uniform.

Mr. Morris: But you can have uniformity and secrecy. I understand the dilemna that you are in with the confidentiality of the tax returns.

Mr. Shapiro: I believe the discovery testimony also disclosed that, according the judgment of the deponents, we have uniformly used apportionment in the auditing of oil companies, multi-state oil companies.

Mr. Ragatz: Mr. Chairman, just as part of that discussion, I would like to interject that that is precisely the dilemna the petitioner has been put in, that the respondent's

witnesses can say we treated them all uniformly, and we have no way of investigating and examining to determine whether that is a correct and honest truthful statement, or whether reasonable accounting minds could differ as to whether they treat them equally.

In fact, during the discovery proceedings there were admissions at particular places with the methods that were not quite identical, but we have been afforded no opportunity to examine that.

Now I fully expect when I ask a question the witness is going to refuse to answer it. My intention is to preserve that question, should it ever be necessary to raise it later on, but I think it points out vividly the handicap that a petitioner in our position is under, not only aren't their rules as to how this very complicated method is supposed to be applied, but we can't even see the application of it to see that we are getting uniform treatment.

Mr. Morris: Mr. Chairman, I understand the dilemna that Mr. Ragatz is in, the taxpayer that is involved in this action, and the records being held confidential for tax purposes, but also you being in the business and representing a large corporation, a method could be developed if this rule is changed in which a competitive company could examine tax records of another competitive company. Now that would be also a problem that Mr. Shapiro would have to face.

The question I am trying to get at is, if this is a rule of the Department on uniformity, how are we going to determine what is uniform and what is not?

Mr. Shapiro: Mr. Commissioner, if I may comment on that, each audit must ultimately stand on its own—on its own feet, on its own merits under the statutory rules in our income tax law, so that what we are testing is the audit of this company based on the statutes. That is basically what we are testing.

Mr. Ragatz: I would like to point out for the record that the argument of counsel for the respondent clearly overlooks the constitutional right to equal protection of the laws, and I have argued this subject before. I don't know how a petitioner in our position nor how the Commission itself can make any intelligent analysis of the equal protection question without this kind of information.

Mr. Timken: Anything further? Mr. Sheridan, are you now in a position to answer the question that has been put to you? Do you want it read again?

The Witness: Yes.

(Question read: On discovery I also asked you whether you were familiar with any oil companies that report for Wisconsin corporation franchise tax purposes on a separate accounting basis for any of their functions, such as E and P refining and marketing. Will you now answer that question?)

A. No.

Q. Do you have knowledge of any other oil company that is currently contesting an assessment based upon apportionment?

Mr. Shapiro: That and the question goes to the same substance of the others unless counsel—

Mr. Timken: Are you objecting?

Mr. Shapiro: Yes.

Mr. Ragatz: I am not asking him to identify it. I am asking whether he has knowledge.

Mr. Timken: The objection is overruled.

A. Yes.

Q. Is there more than one such contest in process?

A. I am not certain.

Q. You are only thinking of one in answering the question to the affirmative?

A. I know of one.

Q. Is that case docketed before the Wisconsin Tax Appeals Commission?

A. I am not certain.

Q. Is that the case of Union Oil and Refining Company?

A. Yes.

Mr. Ragatz: Off the record for a minute.

(Discussion off the record)

(Exhibit Number 17 marked for identification)

By Mr. Ragatz:

Q. All right. I show you what has been marked as Exhibit 17 which counsel for the respondent indicates that it will agree and stipulate it is a true and correct copy of the petition for review of the Union Oil Company of California, which I believe I erroneously called the Union Oil and Refining Company. This is dated May 10th, 1973, addressed to the Wisconsin Tax Appeals Commission and attached thereto is a copy of the Answer of the Wisconsin Department of Revenue which is file marked July 11th, 1973.

Are you familiar with that document?

A. No.

Q. But you are familiar with the fact that the Union Oil Company of California is contesting an audit?

A. Yes.

Q. Were you the auditor on that case?

A. I decline to answer.

Q. Do you recall me questioning you under oath on the 15th day of January, 1974, at the office of the Tax Appeal Commission at 1 West Wilson Street, Madison, Wisconsin?

A. Yes.

Q. And you were under oath at that time?

A. Yes.

Q. Did you answer the questions propounded to you honestly and truthfully to the best of your ability?

A. Yes.

Q. Do you recall me asking you as follows: "Question, Mr. Sheridan, it's been indicated on the record that—

Mr. Timken: What page is that?

Mr. Ragatz: 17; I'm sorry.

Mr. Timken: You may proceed.

By Mr. Ragatz:

Q. "Question, Mr. Sheridan, it has been indicated on the record that the Union Oil case is currently before the Wisconsin Tax Appeals Commission. Is that a company you audited?" And, "Answer, Yes."

Is that your response at the time?

A. Yes.

Q. Why do you now refuse to answer the question?

A. Under Section 71.11, information of this type is confidential.

Q. Isn't the document before you labeled Exhibit 17 now a public record, to the best of your knowledge?

A. Yes, it is; at least I guess it is.

Q. And does that document reflect a protest and petition for review to an assessment that resulted from your audit?

A. It apparently is a protest to an assessment made by this Department.

Q. Is it protesting the assessment that resulted from your audit?

A. Again, under Section 71.11 I think that information is confidential. There was an audit.

Q. You conducted it?

A. (No response)

Q. For what years did you audit it, do you know?

A. I decline to answer that.

Q. I take it that you also decline to answer the question as to the basis on which Union Oil reported its Wisconsin income?

A. It might be here (indicating), I don't know.

Q. I am asking you.

A. I decline under Section 71.11.

Mr. Timken: For the record, Mr. Sheridan, is it my understanding that you are declining to answer these questions, all of these declinations are based upon your interpretation of 71.11 of the Statutes?

The Witness: Yes, sir.

Mr. Timken: So any time you decline to answer, that is your basis?

The Witness: Yes.

By Mr. Ragatz:

Q. I take it you decline to answer as to whether or not you tried to put this taxpayer on the apportionment method?

A. I decline.

Mr. Ragatz: Well, Commission, this illustrates the dilemma the petitioner finds itself in. I would like to move the admission of this exhibit because of his declining to answer. I have not been able to lay the kind of foundation that I hope to, and certainly have not received any information, but I do think the document itself should be admitted in that it sets forth at length an objection to the apportionment assessment and has some bearing on this issue in this case and at least will lend some possible issue of legal protection.

Mr. Shapiro: The respondent will enter its objection on the grounds of relevancy.

Mr. Timken: Off the record for a moment.

(Discussion off the record)

Mr. Timken: Objection is overruled.

Exhibit 17 is received.

By Mr. Ragatz:

Q. Mr. Sheridan, I take it you would decline to answer any further questions whatsoever relating to the manner in which Union Oil reported its income, or the manner in which you assessed it?

A. Yes, sir.

Q. Therefore I will not take any further time with the Commission on that.

Did you audit Clark Oil and Refining Company?

A. I decline to answer.

Q. Are you aware as to whether or not there is a case pending before the Tax Appeals Commission with Clark Oil and Refining Company as the petitioner?

A. I heard of it.

Q. You don't know of your own knowledge?

A. No.

(Exhibit 18 marked for identification)

Q. I show you what has been marked Exhibit 18, which counsel for respondent has agreed to stipulate is a true and correct copy of the petition for review filed with the Wisconsin Tax Appeals Commission by Clark Oil and Refining Corporation, and the filing stamp shows April 20, 1973. Are you familier with that document?

A. No.

Q. I would add that attached to the document is a copy of the Answer of the Wisconsin Department of Revenue, the date stamped is May 8, 1973. Are you familiar with the tax assessment protested by that?

A. No.

Q. You are not?

A. No.

Q. And you have refused to tell me whether or not you audited this corporation?

A. No. No, I did not audit that corporation.

Q. You did not audit that corporation?
A. I did not.
Q. Are you familiar at all with the Clark Oil audit?
A. No.
Q. The Clark case before the Commission?
A. No.
Q. I am intrigued, Mr. Sheridan, to know why you feel that it would be a breach of the confidentiality statute to answer in the affirmative if you had a company, but you do not feel it is a breach of the confidentiality of the stattue to answer "No" if you did not audit it.

Mr. Shapiro: I suggest this line of questioning has no relevancy.

Mr. Timken: Objection sustained. It is argumentative. The record speaks for itself.

Mr. Ragatz: I will hold off with Exhibit 18 until we can find a witness that purports to know something about it.

By Mr. Ragatz:

Q. What training, Mr. Sheridan, prior to the audit of Humble had you received as to auditing of corporations with multi-state operations?
A. Initially in 1963 when I started in the Corporation Section, we had a training session oral in nature from the Section chief, an exhaustive course which dealt with corporation auditing. Then through experience working on corporations, I worked on corporations with multi-state operations.
Q. How long had you worked prior to Humble audit on multi-state audit?
A. Ten years.
Q. I believe you testified that you started with the Department in 1962 and with the Corporation Section sometime in 1963?
A. March.

Q. And that you testified you started the Humble audit in 1970, and is there something wrong with my mathematics or is it yours?
A. I don't understand your question. What do you want?
Q. I can't see where you got ten years' experience between sometime in 1953 and sometime in 1970?
A. Humble was not the only company I audited.
Q. I asked you how much experience you had had auditing multiple-state corporations prior to the Humble audit.
A. Prior to the Humble audit? I am sorry, I didn't hear that. That would be six years.
Q. You mentioned training. Were there documents that were involved in this training?
A. The initial training?
Q. Yes.
A. No, that was oral.
Q. The initial training was oral?
A. Yes.
Q. Did you have any subsequent training that involved use of documents?
A. We have had auditor conferences in which we will discuss a particular topic of interest to the majority of the auditors. It is more on-the-job training. I juniored with two senior auditors, and these audits all were on multi-state corporations.
Q. I take it you had no formal instruction?
A. What is "formal"?
Q. Course work? Course materials. Class room training.
A. When I initially started in the Section we had classroom training.
Q. That was the oral training?
A. That's right.

Q. Did you use the Department's manual, or at least the Sections relating to corporation audit?

A. What section do you mean?

Mr. Timken: Mr. Ragatz, we will break for lunch.

(Noon recess, 12:00-1:30 p.m.)

Mr. Timken: Gentlemen, are you ready to proceed?

Mr. Shapiro: Yes, sir.

Mr. Timken: Back on the record, please.

Mr. Sheridan, you have already been sworn and now, Mr. Ragatz, you may continue.

Examination by Mr. Ragatz.

Q. Before we broke for lunch, Mr. Sheridan, I was asking you about whether you had used the Department's manual as part of your background for your work on multi-state corporation, and I am referring specifically to Chapter 16 out of the manual that has been admitted as Exhibit 10-A in this proceeding; and I ask you if you are familiar with the provisions with Chapter 16 and whether you used that as background in your audit?

A. I did have a copy of this and I am certain I am generally familiar with the contents.

Q. Was that part of your background at the time you commenced the audit of Humble?

A. I can't remember when this was printed. Is there —I don't know when it was put into print.

Q. Your answer is that you don't know whether that was part of your background or not?

A. I am not certain.

Q. Are you familiar with a paper written by a Mr. Longhorn?

A. Yes.

Q. I show you what has been admitted as Exhibit 12-B and ask you to identify that. Is that the paper I am referring to?

A. Yes.

Q. And were you familiar with the paper at the time that you commenced the Humble audit?

A. Yes.

Q. What was your familiarity with it?

A. I had seen it. I had read it.

Q. Would you agree that the audit of an oil company is a far different experience than the audit of another kind of multi-state company?

A. It has its unusual characteristics, yes, but it's essentially a multi-state operation.

Q. One of the unusual characteristics is the complexity of the exploration function, wouldn't you agree?

A. I think it is more in determining the income, determining the income of that department.

Q. You really have that income as a starter, don't you?

A. We were given data here, yes.

Q. And didn't you use in your audit report the eternally determined exploration department income as the starting point in the computation that is known as the barrel formula?

A. The net income, no.

Q. Well, adjusted to the Wisconsin basis?

A. We did use the factual net income.

Q. Of the E and P Department?

A. That's correct, in trying to determine the net income attributable to the crude oil sales with two outsiders.

Q. But your starting figure was the Humble determined factual net income of the E and P Department?

A. For which purpose now?

Q. For the purpose of commencing the barrel formula calculation.

A. No, we don't use net income in the barrel formula computation.

Q. But you did, and I can point out to you in the audit report where you did pick up the company internal gener-

ated income figure as a starting point to your calculation process, is that not correct?

A. Yes, for the purpose that we picked it up.

Q. Now, at the time that you commenced the Humble audit had you been given any specific training of any nature as to the concept of business in Wisconsin for purposes of Section 71.07, subparagraph (2)?

A. Well, I think this training—I would have trained all through my auditing experience. Humble is not that unusual in that it is a multi-state operation. We have many companies that are multi-state operations.

Q. I would like you to specifically answer my question as to whether you were given any specific training as to how to define the statutory concept of what is business in Wisconsin?

A. Exclusively for this audit?

Q. Yes—no, just prior to this audit.

A. Well, as I stated, I have had extensive experience.

Q. But not specific training as to that particular concept?

A. Any company which is a multi-state operation has similar problems; one is determining the net income.

Q. Will you answer my question yes or no?

A. I don't think I can. Rephrase your question.

Q. Have you had any specific training as to how to determine the concept of whether or not a business is unitary?

A. I consider any training that I have gained as being specific training in this concept.

Q. Have you had any specific training as to how to determine the concept of what is an integral part, again for purposes of the statutes I mentioned?

A. I think that related to the prior question. It is gained in the experience of auditing multi-state companies.

Q. So the only training you had was your general experience in auditing multi-state companies?

A. I have the advantage of reading other auditors' papers, which you have shown me.

Q. What papers were these?

A. Well, Mr. Longhorn's.

Q. What else?

A. Can we determine when this was printed?

Q. I am afraid on the witness stand you have to answer questions, not ask them.

A. What is the question again?

(Last question read back)

Q. What other papers had you read?

A. I don't remember.

Q. Possibly you hadn't read any?

A. I don't remember.

Q. I would like to read you a sentence or two from Exhibit 11—10-A at Page 323 which you have in front of you and this is from a section entitled "The Unitary Business Concept," and it is labeled 83.3. Unitary business is one—

Mr. Timken: Do you have it, Mr. Sheridan?

The Witness: No.

Mr. Timken: Let him find it.

Q. Page 323, about the middle. "A unitary business is one which operates as a unit. Its business cannot be segregated into independently-operated branches. Its operations are integrated and each branch is dependent upon and contributory to operations of a business as a whole."

I take it that you concur in that manual's definition?

A. A unitary business is one—

Q. I think you can answer the question yes or no.

A. Yes.

Q. So the test then as stated by the manual is whether the business is dependent upon and contributory to non-Wisconsin activities is your test?

A. What test?

Q. The test that we are talking about, the definition of the test for unitary business.

A. Well, I just wouldn't limit it to that definition.

Q. Now, according to the manual and the statute, I believe you are supposed to make a determination as to whether a business is a unitary business?

A. Correct.

Q. What factual determination did you make in relation to Humble as to the statutory concept of business in Wisconsin?

A. Humble's business in Wisconsin?

Q. What factual determination did you make as to that statutory requirement?

A. Well, we knew that Humble had marketing activities within Wisconsin.

Q. You knew that?

A. Yes.

Q. Did you make a factual determination as part of your audit?

A. Yes.

Q. I assume that you could point out in your audit work papers where that is located?

A. Well, we would have statements even from the Tax Department of Humble which indicated that their marketing activities indicate—in your return you had sales in Wisconsin.

Q. Now I have placed before you documents which have been admitted into evidence here labeled Exhibits 11-t and 11-6, which purport to be your work papers, and I assume they are your work papers on the Humble audits of the years '65 through '68?

A. Yes.

Q. I guess I will ask you a couple other questions before I ask you to tell me where the work papers are located.

You indicated you did make a factual determination as to petitioner's business in Wisconsin. Did you make a factual determination as to whether the petitioner was a unitary business?

A. Yes.

Q. And then I presume that you can point out in your workpapers where that factual determination is?

A. I don't write down everything.

Mr. Shapiro: May I interject at this point. First, the auditor is not an attorney, as we all recognize, and we all know he is not an attorney.

Secondly, the kind of questioning suggests that the auditor in his—that counsel wishes to reflect adversely upon the auditor rather than to concentrate on the merits of the assessment itself, and for that reason we think that this line of questioning should be limited so that the auditor is not being tried but that the assessment in evidence is being tried.

Mr. Timken: So you are objecting to this line of questioning?

Mr. Ragatz: I would like to comment that that objection is out of line and counsel apparently does not understand the line of questioning, and I think I certainly have a right to examine this witness on what, if any, factual determinations he made. I am not attempting to ask him legal questions. I phrased each question, I believe, as to "what factual determination did you make." This was the agent that audited the company that presumably determined the company was unitary, and I think I have every right in the world to find out on what facts he based that decision.

Mr. Timken: The objection is overruled.

(Question read: And then I presume that you can point out in your work papers where that factual determination is?)

Q. Can you find in your work papers where your factual determination is in relation to the unitary concept?

A. As I stated, I haven't written down everything that I have learned while I was at Houston.

Q. Are you testifying that there is no factual determination set forth in your work papers?

A. I will have to look. Again, you are asking for factual determination what?

Q. You told me, I believe, that you made a factual determination that the taxpayer was a unitary business?

A. Yes.

Q. I would like to know on what facts that determination was made and where that is set forth in your work papers?

A. On my work papers, "C" we know that Humble had extensive sales—I know from looking at functional accounting records that you had sales from the E and P Department to Refining, sales from Refining to Marketing, and we know that you have reported sales in Wisconsin, you have print-outs which show and isolate all of these sales into Wisconsin, so here is an instance where all sections of your company are operating with one goal in mind, and that is to make the sale.

Q. Is that what your determination of unitary was based on?

A. I don't think there is any one answer.

Q. Well, what other factual situations was it based on?

A. Well, we know that Wisconsin was just part of a region—Wisconsin was part of the Midwest Region.

Q. Do you have that in your work papers?

A. Well—(witness looks through papers) I have photocopies which were given to me by Humble showing your exploration divisions, marketing regions, your refineries and plants, producing divisions, marine activity, and if you look at that map you will see where the Central Region includes 10, 12 states; and it says it has a headquarter—or a regional office at Memphis. This happens to be dated May and June of '68.

Q. Is that what you based your defining of "unitary" on?

A. Well, this is one part.

Q. All right. What else?

A. Pardon?

Q. What else?

A. Just the dependence of one division upon another.

Q. Did you make a factual determination as to dependence?

A. Well, I think I had various talks with various people in the Humble Tax Department as to general operations of Humble Oil Company, and it is a known fact that they can't operate a refinery without crude and that they have a supply department. This department is buying the crude to operate that refinery and we know the product has to get out of the refinery and into marketing; and somehow you got to sell it. To me these are qualities which lend toward a unitary company; no one fact.

Q. Is that laid out in your work papers?

A. Not in specific words like that. This is an over-all determination.

Q. It is a big company, right?

A. Very big.

Q. Does that make it unitary?

A. Just being big, no.

Q. Just operating in multi-states, does that make it unitary?

A. No.

Q. What is it that makes it unitary?

A. A variety of activities of that company.

Q. Well, can you enumerate them?

A. Bigness could lead towards unitariness. Operating in many states could lead towards unitariness.

Q. You had to make a factual determination of unitariness, and I have asked you several times to enumerate for me what facts you considered in arriving at that conclusion. You said a lot of vague things, and can you be more specific?

A. Definitely. The direct—the total operations of this company starting with securing oil to refining that oil to selling that oil or the refined product, this was all part of a company. To me this is a unitary operation. It is where Wisconsin is contributory or dependent upon the operations out of the State, where Humble is headquartered in Houston, Texas, this controls this whole company out of Houston.

Q. Where does it say that in your work papers?

A. On the same page.

Q. What page is that?

A. These maps, it shows Houston as the headquarters, and the word "headquarters"—you are direct in something.

Q. Does it say that Houston controls the Wisconsin operations?

A. No, it doesn't say that.

Q. Does it say anywhere in your work papers—

A. Well, it is as I stated that we—

Q. What facts do you base your purported knowledge on?

A. Speaking with people in the Humble Tax Department.

Q. And they told you that Houston controls the Wisconsin operation?

A. Well, Houston is called your headquarters, company headquarters. Humble is a company.

Q. So it is your conclusion that Houston controls the Wisconsin operation?

A. Yes, sir.

Q. And you were not told that in Houston?

A. Houston controls the operations of Humble.

Q. Answer my question. You were not told in Houston that Houston controls the Wisconsin operation?

A. Indirectly it might have, Wisconsin being a marketing state would have reported to a marketing office and the marketing office would have reported to the region, and the region to the headquarters.

Q. Were you or were you not told in Houston that Houston controls the Wisconsin operation? I think you can answer that yes or no.

A. What are you asking for? A direct statement? Did somebody say that identical statement?

Q. Yes or no.

A. No, nobody, no.

Q. That is your conclusion then?

A. No, you asked me for my—

Q. Have you any other facts set forth in your work papers that you assert supports your determination that this is a unitary company?

A. Well, we can look at your functional income.

Q. Do you have that in your work papers?

A. I think I have parts of it. We do have—in 1968 I happened to make a copy of what Humble called their Comp. Code, and it was their income by functions, and it showed out of—well, let's say six and a half billion dollars in sales, almost three billion is eliminated on an intra-company elimination, and that means that that had to be sales from one department to another department within Humble, and they have been excluded.

Q. I take it you are aware that Humble set up an organized functional department?

A. This is not unique.

Q. And functional profits and losses are determined as to each function?

A. Yes, that's apparently how they internally account.

Q. What other facts did you base your unitary determination on?

A. Well, the knowledge that most of the staff activity of this company is in Houston.

Q. Is that in your work papers?

A. I don't think that I have a statement that says "staff activity is at Houston." I was told that. We knew the tax departments down there.

Q. What other facts?

A. Tail-ending accounting is at Houston.

Q. The what?

A. Tail-end accounting is down at Houston.

Q. What do you mean by that?

A. Well, the preparation of the financial statements, book statements. This would all be summarized at Houston.

Q. Does that make it unitary?

A. This can blend in all their audits.

Q. Do you have that in your work papers?

A. No, this is again knowledge that I have been told. I don't write down everything I do. I am not a lawyer.

Q. Do you have a section of your work papers where you summarized the factual determination that you made there that allows you to arrive at the conclusion that Humble is unitary?

A. I will have to go through my work papers.

Q. All right.

A. At this point Humble was actually a wholly owned subsidiary of Standard Oil, New Jersey, also which is just one company owning another company.

Q. Does that make it a unitary company?

A. It lends a little credence to this.

Q. What facts do you base that statement on?

A. Well, that Humble is a subsidiary of Standard Oil, New Jersey?

Q. No, that that has anything to do with whether or not it is unitary?

A. I am not sure that particular statement—I would have to think about that one. The fact that they do have intra-company sales and cost of sales and elimination indicates that there are activities between these companies.

Q. Where in your work papers have you summarized the facts upon which you base your determination of unitary?

A. I don't have any one statement. My whole paper is a product of my audit and I might have it throughout. I don't necessarily put down one line as such, "Humble is unitary." It is the summary of my whole audit, my conclusions based on everything that I learned about it is that Humble is a unitary operation and I was trying to show you various things which enter into this that really convinced me.

Q. Well, a review of your work papers would reveal a lot of your accounting schedules, but not much else. Is it your position that the accounting schedules establish that the company is unitary?

A. Certainly accounting facts enter it. For example, your one on sales, just running on out to E and P, not the refining, in one year it has to be 700 million and this 700 million gets eliminated because it all went into refining.

Q. Does that make it unitary?

A. It shows that these two divisions are operating and we know that refining has to get rid of it, too.

Q. And you've come to that conclusion because you say that production flows from E and P to refining?

A. It runs all the way through the company.

Q. It doesn't come into Wisconsin, though, does it?

A. I think products come into Wisconsin.

Q. Do you have any information that says one drop of Humble produced crude oil or heating oil comes into the State of Wisconsin, or one drop of gasoline?

A. I think all their lubricants as greases and oils and possibly chemicals all come into Wisconsin.

Q. Do you have any information in your work papers to make that statement up?

A. I will find it. I notice in one of my statements here I made the statement that a sales and use manual was described by the tax department in Houston and was apparently throughout the company. This would show again a dependence on outside of Wisconsin, and when I was doing the sales and use tax examination—

Q. I believe that that has nothing to do with the question before you. The question before you was do you know or do your work papers show that any drop of gasoline or heating oil sold by Humble is sold in the State of Wisconsin and was produced by Humble E and P?

A. I answered that question no. I was talking about lubricants and motor oil which are your own. This statement was given to me. The name says Exxon on a can of oil.

Q. Apparently you can't find—

A. As I said, I don't write down everything I do on the audit either.

Q. But you agree that no gasoline or heating oil produced by Humble was sold in the State of Wisconsin?

A. I don't know that fact, correct.

Q. But you have no facts that would indicate to the contrary, either, do you?

A. I think it is I probably didn't. It seems economically infeasible to ship up to Houston.

Q. Answer the question yes or no. You can testify on direct examination if you want to make an estimation, but you will have to answer my question directly.

A. If I can.

Q. Now, what facts did you consider in making a determination that the business of Humble in Wisconsin was an integral part of a unitary business?

A. Well, we knew that the warehouse for all the package products was in Chicago and supplied in Wisconsin.

Q. That makes the Wisconsin operation an integral part?

A. Not backed on facts.

Q. The packaged products represent a pretty small percentage of the volume, don't they?

A. But it is a part of Humble's business, packaged products.

Q. I suppose you can say a couple percentages is part, but it is a pretty small part?

A. I really wouldn't know. I would imagine so.

Q. What other facts did you base your determination of integral part on?

A. Well, we know that the marketing people came under in the chain of command from outside of Wisconsin.

Q. Do you have that in your work papers?

A. I just told you that, about that map; that the marketing region was at Memphis.

Q. Did the map show that?

A. Well, it indicates that.

Q. What other facts do you have?

A. I think you have some salesmen go from Wisconsin into—or from Illinois into Wisconsin. I don't know if the reverse is true.

Q. Do you have that in your work papers?

A. It seems that I have a check list showing the stations involved and their salesmen. The Beloit bulk plant is operated by an Illinois staffman.

Q. Do you have that on your work papers?

A. Yes.

Q. What other facts do you have?

A. What was the question again?

Q. What other facts do you have that you based your determination that the Wisconsin operations of Humble were an integral part of a unitary business?

A. Again I think it is a situation where you have to look at the company as a whole and then see where does Wisconsin fit in. It happens to be a marketing state. Geographically there are no wells in Wisconsin so there is no exploration here.

Q. And there is no refining here either?

A. That's right, but there is marketing and that's part of this business. The business of Humble is to secure, produce, refine and market, and Wisconsin is a part of this. It just happens that Wisconsin is part of the marketing department.

Q. There are a lot of independent marketers, aren't there?

A. I think there are fewer today.

Q. But there are thousands of independent marketers, aren't there?

A. I don't know that.

Q. At any rate, a great number?

A. I don't know that.

Q. And the service stations line up right across from each other; there might be an independent station on the same corner as the Enco station, might there?

A. Might be. It is less frequent though. Most are major companies, integrated companies.

Q. Did you consider any other facts in arriving at your integral part determination?

A. Wisconsin was certainly dependent on outside of Wisconsin to get the product to sell.

Q. It brought the product from here?

A. Well, I am not sure. That was some—They always had their own manufacturing plants that created lubricants and greases and that was all eventually filtered into

Wisconsin; and so Humble operates as a nation-wide company.

Q. How about gasoline? Do you know where they got their gasoline?

A. I think it came either from exchange or purchased.

Q. From an outsider?

A. From another oil company, yes.

Q. How about fuel oil?

A. I think the same is true.

Q. Heating oil?

A. I think the same is true there.

Q. Do you know whether or not those three products constituted the greater percentage of the business done by companies in the State of Wisconsin?

A. I believe that's true.

Q. And you do know that the acquisition of all those three products came from other companies?

A. Well, I am not exactly certain how they got ahold of all this product.

Q. But it wasn't product refined by Humble, was it?

A. I don't think it was.

Q. And it wasn't from crude oil or natural gas produced by Humble either, was it?

A. These three areas?

Q. That's right.

A. Right.

Q. Now you stated that the Wisconsin operations were dependent on the rest of the company. What facts do you have to support your statement based—let's concentrate on each function. What facts do you have that Wisconsin's marketing operations by Humble were dependent upon its exploration and production functions?

A. Well, marketing to obtain a product in order to sell it.

Q. That's your fact?

A. And obtained its product from refinery or purchased it. This must take tremendous coordination.

Q. Is that your answer to my question as to why Wisconsin—

A. I don't think there is any one fact that can establish an answer to the question you have asked. It's an overall judgment on my part. Many facts, many little things that might seem incidental by themselves, all seem to indicate that this is the way Humble operates. And, as such, to me that's a unitary concept; that's a unitary business.

Q. So that's why you say that Wisconsin marketing was dependent upon Humble's E and P?

A. Well, if you didn't have E and P you wouldn't have had that oil to make into the can to sell in Wisconsin as car oil, would you, or lubricants?

Q. Well, let's talk about the fuel oil and the gasoline and heating oil.

A. Well, there you merely bought it or exchanged it with somebody else because it's economically feasible for you to buy rather than ship your own product up here.

Q. So you are really not dependent upon Humble's E and P for those products, are you?

A. Not Humble's own product because, for their own reasons, tended to buy—

Q. Now what facts do you have that would indicate that the Wisconsin marketing operation was dependent upon Humble's refining function?

A. Well, again, marketing has to have a product to sell.

Q. Let's take the fuel oil, heating oil and the gasoline. What facts do you have that would indicate that Humble's marketing which didn't market, you agree, any Humble refined of those three products; what facts do you have that would indicate that Wisconsin marketing was a dependent upon Humble refining?

A. They had to get the lubricants, oil, chemicals, liquids.

Q. I am talking about the three major products.

A. Well, you just stated that they bought it from somebody else or exchanged it.

Q. So they really weren't—

A. Somewhere there is somebody that was in charge; and they had to be securing apparently this product or they had to be exchanging all this product and get it into Humble's system.

Q. But they weren't dependent upon the product refined by Humble itself, were they?

A. You can't trace one barrel of crude all the way through Humble.

Q. Well, you weren't able to do that, were you?

A. I don't think anybody can.

Q. Well, what facts do you have that Wisconsin marketing was dependent upon any other functional department of Humble?

A. Somebody prepared that return.

Q. Is that your answer?

A. Well, that's a statement, isn't it? Somebody prepared that return. That means it took accounting or tax or legal or somebody that was involved in the Wisconsin operation. You have various taxes that had to be handled by somebody.

Q. And that made Wisconsin's operations dependent upon somebody?

A. Same thing. Not one fact can be decided on.

Q. But I am asking you to explain on what facts you based your determination. You said you made a determination and I think I am entitled to know what facts you based it on.

A. The internal coordination amongst this company.

Q. And is that laid out in your work papers?

A. Well, just taking your functional income you see where you have a sale of crude oil from E and P to refinery. And then you take refined products from refinery to marketing and then it goes from marketing to the consumer, and you have tremendous—You have almost three billion dollars of eliminations which shows that this is all intra company.

Q. But other than a very minor amount of packaged products, there was none of this three billion, as you say, of crude oil that came into the State of Wisconsin, was there?

A. The point is the company did have this.

Q. No. Answer my question yes or no.

A. What's the question?

Mr. Ragatz: Read the question, please.

(Question read)

The Witness: Other than packaged products. I would think we would also want to say other than liquids or chemicals or anything but those three items of heating oil, fuel oil and gasoline.

By Mr. Ragatz:

Q. Well, what facts do you have that would indicate that anything else besides packaged products that was produced and refined by Humble ever came into the State of Wisconsin?

A. I don't know exactly what every dollar sale in Wisconsin is, if that's what you are asking me.

Q. Well, you didn't make a factual determination as to that then?

A. I don't analize all of the sales to determine what the product is. When the company says, I made 12 million dollars or 18 or 20 million dollars of sales—

Q. But you have no facts then that would indicate—

A. The commodity?

Q. —that other than a minor amount of packaged products that was produced and refined by Humble ever came to the State of Wisconsin?

A. I only know they are Humble's sales. I don't know by Commodity.

Q. All right. That's fine. You don't know.

A. By commodity.

Q. All right. Now you indicated that you used certain facts to arrive at the decision that Humble was a unitary company?

A. To arrive at the decision that Wisconsin operations were an integral part.

Q. Were those the same facts in each case?

A. Well, the question of a unitaryness is many determinations. I don't quite understand your question, are they the same facts.

Q. Well, you testified to a lot of nebulous things and I would just kind of like to have you differentiate and tell me if there is any difference in the factual determination as to whether a company is unitary versus the factual determination as to whether Wisconsin operations are an integral part.

A. The operations are an integral part.

Q. Well now, you are stating a conclusion. I want to know the facts and whether the facts you used there are the same facts that you used to arrive at the conclusion that the company was unitary. Is there a difference in your mind or is it all kind of wrapped up and spinning around?

A. Was it what?

Q. Strike that.

Is there a difference in your mind as to the facts that you would use to make those two determinations?

A. The question of unitariness is an overall conclusion and I think Wisconsin is a part of that conclusion.

Q. I am not asking you for conclusions; I am asking you for facts.

A. Well, in all the information I obtained Wisconsin was an integral part.

Q. Well, all right. But is there a difference in the actual determination of that versus the factual determination of the business being unitary?

A. I don't think there is any question the company is unitary.

Q. I wish you would answer the question. You are not answering the question.

Would you read him back the last question, please.

(Question read)

Mr. Timken: Let's break for ten minutes. It's been an hour.

(Short recess taken)

Mr. Timken: Before we proceed I think we are running into a little trouble. Maybe wa can clarify it.

The answers and the questions at times are overlapping, so I would appreciate it if you gentlemen would have a pause so we can get everything down. Mr. Sheridan, if you don't understand a question, I urge you to ask counsel to rephrase it, and if you don't know the answer, I think you should say you don't know the answer and try to be a little more responsive, if you would, please.

In other words, I don't think it is proper to reply to a question with a question. If you don't understand the question, say so and we will handle it in that manner.

You may proceed.

By Mr. Ragatz:

Q. Mr. Sheridan, so as to not belabor the point we were struggling with before we broke, I would like to ask you in summary, would you agree with me that whatever facts you considered in making your determination that Humble was a unitary company, that these were the same

facts that you considered in concluding that the Wisconsin business was an integral part of that company, is that not correct?

A. Yes.

Q. All right. I believe you concurred in the manual's definition of "unitary" as it related to the word "dependent upon and contributory to the business as a whole," and I asked you about the dependency aspect, but I haven't asked you about the contributory aspect.

What facts did you base the determination on that Humble's Wisconsin business was contributory to the operation of the business as a whole?

A. Well, it is contributory in that it provides an outlet for Humble's sales, and these sales do generate net income.

Q. Is your answer then that it contributes profit?

A. A normal sale will.

Q. Or a loss.

A. Profit or a loss.

Q. Did you make a factual determination on what ways the Wisconsin operation contributed to the overall operation?

A. Well, your returns had shown a loss and the manner—since I considered Humble to be a unitary operation and used apportionment, statutory apportionment, net income was realized.

Q. In other words, the contribution you are talking about was made only because of the application of your formula that produced taxable income?

A. Well, I don't believe apportionment isolates the particular dollar of profit to a particular dollar of sale like separate accounting tends to do.

Q. I don't believe that answer was responsive.

A. Would you rephrase the question?

Q. Would you read the question?

(Question read)

A. The apportionment method did report taxable income.

Q. That is the contribution you are talking about, a contribution of purported profit?

A. No, I can't under a unitary concept—you can't isolate profit to a dollar of sale.

Q. I am talking about contribution and you have responded to my question saying that the contribution of the Wisconsin operation was in terms of profit per your calculation?

A. Wisconsin had sales, normally sales would contribute to profit.

Q. That was your factual determination?

A. That is one of them.

Q. What else? Were there any other factual determinations as to how the Wisconsin operation contributed to the overall operation?

A. I think that statement should really read "dependent upon and/or contributory to the operation." It is just a part of the unitary company, and when you look at Humble as an overall company, Wisconsin is just a piece of that company, and I don't see how you can isolate it. I can't really isolate Wisconsin. It is an overall part of this company.

Q. You still say it contributed—

A. It contributed sales.

Q. To the whole, if it incurred substantial losses?

A. This depends on how you want to determine what the income is.

Q. Just assuming any way you determine it, there are losses, and would you still say that the Wisconsin operations contributed to the whole?

A. On a unitary theory, yes, any sale contributes to the profit.

Q. Even if in effect you are contributing a loss?

A. That depends on how you are determining it. You determine it one way—

Q. I just asked you for the moment to assume that whichever way you determine it—

A. You could have income, maybe you could have a loss, I don't know.

Q. Now the definition in the manual refers to a business that cannot be segregated in the independent operating branches. What facts did you consider in making a determination that the Wisconsin marketing operations couldn't be segregated into an independently operating branch?

A. Would you repeat the question, please?

(Question read)

A. Since I determined that I felt Humble was a unitary company, I didn't look to see if Wisconsin could have operated as a branch. I wouldn't—

Q. You didn't make any determination on that?

A. Whether Wisconsin could be operated as a branch, no.

Q. You do recall that the predecessor to the Wisconsin operation was a separate corporation?

A. I am not certain of that. I think that was Pate being a separate corporation?

Q. Right.

A. I believe that is the case.

Q. Did you make any factual determination as to whether Humble's E and P function could have been operated independently, segregated and operating independently as a separate unit?

A. Whether it could have—

Q. Yes.

A. No.

Q. You did not make a determination?

A. No.

Q. Did you make a determination as to whether Humble's refining function could have been segregated and operated independently as a separate unit?

A. No, no.

Q. Did you make any determination as to whether Humble's marketing function could have been segregated and operated separately as an independent unit?

A. What do you mean by "independent unit"?

Q. Like a separate company.

A. No, I didn't.

Q. You didn't?

A. No.

Q. Did you make a similar determination as to any of the other operating functions of Humble?

A. No.

Q. Such as land management, minerals, coal and shale oil, or marine?

A. No.

Q. You made no such determination?

A. No.

Q. I believe in your discovery deposition you indicated that in October of 1968 you attended some kind of a conference at the Department of Revenue where a paper was given. Do you recall that conference?

A. Yes.

Q. And can you identify the paper?

A. There were various papers.

Q. You say there were various papers given that day?

A. Yes.

Q. Was there one particular paper given by Mr. Kaspar?

A. Yes.

Q. I show you what has been admitted into evidence as Exhibit 11-11, and ask you if that is a paper we were just referring to?

A. That looks like it.

Q. And that is by Mr. Kaspar and a Mr. Paul?

A. Yes.

Q. And that was presented at the 1968 conference?

A. Yes.

Q. And you were in attendance at it?

A. Yes.

Q. Who was in charge of that conference, if you recall?

A. Probably Mr. Leidiger and Mr. Hoel.

Q. What was the subject of this conference?

A. Topics of a general nature of interest to the auditors.

Q. At least part of it related to oil and gas auditors?

A. This one paper, yes.

Q. Who was the co-author of that paper with Mr. Kaspar?

A. Ralph Paul.

Q. Is he an experienced oil and gas auditor?

A I don't know

Q. You don't know?

A. I don't know of his qualifications.

Q. I believe you told us on discovery that he had little oil and gas experience, do you recall that?

A. I think that is true.

Q. Now, did your Department have an oil and gas auditing section?

A. No.

Q. Have you read any books on oil and gas accounting or have you prior to the audit of Humble read any books on oil and gas accounting?

A. As I stated, there were various books in the library which were available. I don't know how much I looked at one book, probably just, you know, to get an overall refresh—

Q. Look at the inside cover of Exhibit 11-11. Are these the books you are referring to?

A. I believe these are the books that are in our library, yes.

Q. And I believe you indicated on discovery that you may have glanced at the books by Mr. Miller and federal income tax of oil and gas?

A. I might have looked at both of them; I'm not certain.

Q. I believe you told us on discovery that you read no other books or articles prior to the Humble audit?

A. Well, the books are available. I am not positive of every procedure I took before I went down to Houston, but they were available in our library and I am sure I glanced at one or the other or both.

Q. And do you recall my questions on discovery examination in connection with these books?

A. No.

Q. I refer you again to the examination of you that I conducted on January 15th, 1974, and specifically to Page 22 of that examination. "Did you examine any books, articles or the like in connection with the taxation of multi-state corporations?"

I'm sorry, I'm on the wrong page. It's Page 21. "In connection with your oil and gas audits, Mr. Sheridan, what books have you read on oil and gas accounting or related matters? Answer, I believe I looked at the book that is called, I think *Oil and Gas Accounting*. I believe it is listed on that list of books, that single sheet." And then I state, "Let the record show that you are identifying the Miller book."

A. Okay.

Q. Then, "Question, But at the time you were conducting the audit of Humble, this is the book you examined? Answer, I think so. I just glanced at it. Question, You didn't read it as such? Answer, No, I did not. Question, Would you say you spent any considerable amount of time on that? Answer, No, no. Question, were there any other books or articles or the like that you examined in connection with your audit? Answer, I don't believe so."

Now, this was the testimony that you gave under oath at the time?

A. Yes.

Q. And you believe that to be correct?

A. Yes.

Q. I take it then that you had not read at that time a book by the authors of Altman and Kiesling entitled *Allocation of Income and State Taxation?*

A. I believe I had read that book before then. We have that book in our library.

Q. And you read it before when?

A. Oh, any time between 1963. I have looked at that book. We have various books on income tax and allocation of multi-state companies.

Q. And you were not testifying correctly under oath when I asked you that question?

A. You asked me what I read before I went to Houston. Now, are you asking me what I know—of what books or what book I read to go to Houston or just prior to Houston?

Q. I think the question was asked both ways actually. I think the answer was the same.

Did you examine the Altman and Kiesling book in connection with the audit of Humble?

A. No, I was familiar with that book prior to going down to Houston. I had read other books on multi-state operations.

Q. Did you use that book in connection with the Humble audit?

A. No, I had read it.

Q. Had you read that article in Houston entitled the "Unitary Concept of Allocation of Income" published in 1960?

A. No.

Q. Have you ever heard of that?

A. No.

Q. Did you ever read anything written by a Mr. Allvin?

A. Yes.

Q. Had you at the time of this audit of Humble read anything by Mr. Allvin?

A. No.

Q. Now, do you recall at the time of the discovery examination my request that you provide us with information on all books related to oil and gas taxation that had been used?

A. I think I did.

Q. Well, then—

A. I didn't have any books.

Q. Then you are saying that you did not use the Kiesling book, the Altman and Kiesling book at the time?

A. I never said that. I said I was familiar with the contents of the book. I had read the book sometime between 1963 on. I had looked at the book.

Q. But you did not respond when you were under oath before and the question was propounded to you, what other books on the subject had you examined? You did not say anything about that book.

A. I don't remember. Is it in there? Is it in the discovery?

Q. I read you your answer that you didn't examine any books.

A. I read many books since 1963.

Q. When you were testifying under oath at the time—

A Since I was with the Department I was under the impression that you were trying to find out or obtain—

Q. I think you can answer the question yes or no?

A. Prior to going to Houston, had I ready any books prior to going to Houston?

Q. I would like to read from Page 22 of the examination identified before. "Question, did you examine any books, articles or the like in connection with taxation of multi-state corporations? Answer, Well over the years I have looked at various books, you know, we have CC Series, Prentice-Hall Series, and we have various tax theories that I have looked at from time to time when necessary. I think I have looked—we have books in our library called, I think, *Taxation of Multi-State Operations* or something. I have looked at various books like this, yes. Question, Did you study any of these books in connection with your audit of Humble? Answer, Of Humble? Question, Yes. Answer, No."

Now, is that correct?

A. I was telling you right there I had read these books, but I did not look at them specifically to go to Humble.

Q. I take it that you did not remember the Altman and Kiesling books at the time?

A. I believe I said right there I read numerous books.

Q. But you did not read that in connection with the Humble audit?

A. No, I didn't.

Q. And you did not consider that book in connection with the Humble audit?

A. Correct.

Q. You don't remember what that book may have said?

A. I am familiar with the book.

Q. But in connection with that audit, you didn't refer to that book?

A. No.

Q. Now, what, if any, use did you make of Longhorn's paper in connection with the Humble audit? I am referring to Exhibit 12-B that is in front of you.

A. Well, since we had a prior audit which had gone into this in much more depth, I did not spend a lot of time using Mr. Longhorn's paper as any kind of a guide.

Q. Your testimony is that you did not ask the question set forth in the Longhorn memo?

A. Correct.

Q. And that Mr. Longhorn's paper is supposed to be a guideline for auditing multi-state companies, I take it?

A. It's a guideline available to the auditor, yes.

Q. And your testimony is that you did not really use it?

A. No.

Q. Who was the supervisor that made the assignment of the Humble audit to you?

A. David Garno.

Q. And what was his position?

A. Fuel audit supervisor.

Q. And who was his boss; who did he report to?

A. Carl Hoel.

Q. And who was Mr.—

A. Wait. At that time back when I did the audit?

Q. That's right.

A. I think it was probably Mr. Leidiger then.

Q. But you are not sure, I take it.

A. Well, it was one or the other that was the director of the section.

Q. I believe in January you told us it was Mr. Hoel. What's your current opinion?

A. One or the other.

Q. Do you know what positions these two gentlemen held at the time?

A. Yes. Mr. Hoel followed Mr. Leidiger. That was the section.

Q. And what position did Mr. Leidiger move on to?

A. I think he was a deputy to the secretary of revenue.

Q. I believe you told us in January he was the director of field operations. Which is correct?

A. Well, he was also the director of field operations. He spent I think a year or so as assistant to the secretary. I mean, these can be fully explained if you want to know exactly who was where at a particular time.

Q. Now Mr. Kaspar, who is the author of that paper we referred to, I believe you said he had conducted the prior audit of Humble Oil and Refining Company?

A. Yes.

Q. What was his position at the time you were assigned to the second Humble audit?

A. Well, he went from field auditor at Madison to I believe reviewer within the section and then to, I believe conferee within the section, and then to office audit supervisor, all within the section. So during this period he was in Madison in one of those capacities.

Q. And not related to the oil and gas audits particularly and your audit?

A. I don't believe he was even a field auditor then. I think he was in one of the three supervisory capacities.

Q. Now the course of your audit of Humble did you consult with Mr. Garno?

A. I am not certain.

Q. Did you consult with Mr. Kaspar prior to initiating the audit?

A. Not on anything specific.

Q. Is your answer no, you didn't?

A. I am not certain.

Q. What instructions did you get at the time you were assigned the audit?

A. Just to make the audit.

Q. Were there any written instructions as to how to conduct the audit; what year to cover or anything like that?

A. Well, yes. They would have sent me the returns for 1965 to 1968 and they would have sent me the prior audit work papers and the prior audit reports. This is customary.

Q. Now I show you a document out of Exhibit 5 that is sub-numbered S-4 and it's the last page of that S-4 part and ask you to identify what that document represents.

A. Well, that's the letter that came from Mr. Garno when he sent the Humble file to me for examination.

Q. And that's all that came with it?

A. Yes. But he says he sent the income franchise returns. I believe I have the sales and use returns. I have the withholding returns and I also had the prior work papers of this corporation.

Q. And so with this departmental correspondence you received the work papers of the prior audit?

A. Yes.

Q. Now those work papers are the two voluminous documents that have been admitted into evidence here as Exhibits 2 and 3; is that correct?

A. Yes.

Q. Now did you get any other instructions at the time you were assigned the audit beyond the one-page departmental correspondence we have just discussed?

A. No.

Q. No other instructions?

A. No.

Q. Now what use did you make of the prior audit work papers, that is Exhibits 2 and 3?

A. Well, the first thing I would have done is look at the whole set to kind of get a feeling of what went on during that examination, to get a general feel of Humble.

Q. Is it your statement that you used those papers as to model for your audit?

A. That's along with the paper presented by Mr. Kaspar.

Q. Those were your guidelines?

A. Yes.

Q. I take it you were aware that Humble paid an assessment as a result of that prior audit and did not contest the assessment through to a hearing in the Wisconsin Tax Appeals Commission?

A. Yes.

Q. I take it you would also acknowledge that assessment was paid under protest expressly reserving the issues and without agreeing to other than pay the money?

A. They wrote that in a letter.

Q. How much time did you spend auditing Humble?

A. You mean time at Houston?

Q. Well, I think I already asked you that. How much time total did you spend?

A. Well, I believe I say here 32 days.

Q. That's working days?

A. Yes.

Q. Did you consult with Mr. Kaspar during or after the audit?

A. I am not certain.

Q. But you followed the pattern of his working papers?

A. Yes.

Q. I believe that you told us on discovery that during the course of your audit you got everything that you asked for from the taxpayer?

A. I believe so. I did make the point I didn't have the organizational chart in there and I had to question—I didn't mark it off, so I don't know if I didn't get it or whether I didn't pursue it. But other than that I feel—

Q. You don't have any record, though, that you asked for it?

A. Well, I have, I believe, in one of my notes, I have the questions there, organizational charts; and I don't happen to have it in my work papers. I did get the photo-

copies of those regions and I thought I asked for organizational charts at the same time. But other than that I am sure I was furnished everything I asked for.

Q. And I believe you acknowledged in discovery that you had got everything that you were sure you asked for?

A. With the exception of the one item.

Q. And I believe you also acknowledged that you were not refused the right to speak to anyone that you requested to speak to?

A. As far as I know.

Q. Now did you make an examination of Humble's tax returns filed with the State of Wisconsin on a separate accounting basis?

A. No.

Q. I believe you testified at the discovery proceedings that you accepted the sales as reported with only a minor adjustment?

A. Yes.

Q. And I take it then you were satisfied that they reflected the gross revenues from Wisconsin activities?

A. Yes.

Q. And I believe you said at the discovery proceedings that you did not check the Wisconsin cost of sales?

A. Correct.

Q. Now you were following Mr. Kaspar's pattern and I take it then you knew that he had traced the cost of sales and found no basis to challenge the recorded figures?

A. I am not certain as to what depths Mr. Kaspar went on that.

Q. I believe you said that you did not check the operating and overhead expenses?

A. Correct.

Q. Then you obviously have no basis for disputing the accuracy or correctness of the reported figures?

A. Since I determined it was a unitary company, I did not need to know separate accounting data. Therefore, I did not look at it.

Q. But you have no basis to dispute the figures the taxpayer reported for in fact the Wisconsin expenses?

A. I did not examine those figures.

Q. Then I take it you wouldn't know which of those expenses were directly recorded and which were allocated?

A. No.

Q. Then I take it you have no way of saying that Humble's Wisconsin operating result as reported on the basis of separate accounting on the returns filed with the Department do not truly reflect the activities of Humble in Wisconsin during the years in issue?

A. I didn't accept the manner in which they filed, therefore I didn't examine the way that return was prepared.

Q. So you have no way of saying that the results as reported are not truly reflected because you didn't examine them?

A. I don't know what those figures purport to show because I didn't examine them.

Q. You have no basis, though, to challenge any particular figures?

A. The only one I looked at was sales. The remainder of the figures on the return I did not examine, so I don't know anything about those figures.

Q. So really you made no determination as to whether, if separate accounting were deemed an appropriate reporting method, the separate accounting returns as filed properly reflected Humble's Wisconsin income?

A. No, in my view the company was unitary, therefore I would have used apportionment and I would not have spent the time on separate accounting.

Q. That is not responsive to the question. I said, you made no determination as to whether the separate account-

ing figure, assuming separate accounting was deemed appropriate, correctly reflected Wisconsin income?

A I did not make that determination.

Q. Now I believe in your audit you made a decision to treat the petitioner's natural gas income of its Exploration Department different from the way Mr. Kaspar treated it, do you recall that?

A. Well, I might have made a refinement in the method in order to determine the net income which was natural gas income.

Q. Do you recall treating the gas system sales and the gas lease sales as income allocable to situs?

A. What kind of sales?

Q. Gas system sales and gas lease sales.

A. We treated those as sales following situs.

Q. And you treated gas plant gas sales as apportionment, is that correct?

A. Yes.

Q. Now do you know what happens to the gas at a gas plant?

A. From what I have been told by people from oil companies, apparently very little natural gas is in effect dry gas, it can be even a gas-oil combination well, it goes into this gasoline plant which I think takes out impurities and also extracts what they call gas liquids, and I think then the remainder is dry natural gas.

Q. That is your understanding of what happens at a gasoline plant?

A. Yes.

Q. Do you understand that there is any change in molecular structure of the gas?

A. I don't know about that.

Q. You don't know?

A. No.

Q. Do you know what happens at the separator at the well head?

A. My impression was that that was to take off mainly waste——water—waste material, I thought. I think that is what it was.

Q. But you are not sure?

A. No, I am not sure.

Q. If there was no conversion of natural gas to new products in either the separator or the gas plant, then would you consider the income from sales after either of these steps to be allocable income or apportionable income?

A. If there were no what?

Q. If there were no conversion of the natural gas to new products in the gas plant or in the separator?

A. Well, if there were no manufacturing activity, we would have considered this gas yet gas at the situs.

Q. And you would consider manufacturing activity as you put it to be something that converts the gas or the oil into a new product?

A. Yes, or its manufacturing activity, I think that is what a gasoline plant is, it is a manufacturing plant. It is manufacturing activity.

Q. What does it manufacture?

A. Well, liquids, it dries out the gas, I don't know what else it does. It is a fractionization process.

Q. I believe you testified you didn't know whether there was any molecular change in the gas that came out—

A. If fractionization changes the molecular structure, I don't know. I have been told a gasoline plant is a fractionization process.

Q. I take it you don't have any direct knowledge on this at all?

A. No, this is what people have told me.

Q. Who told you that?

A. Various people from all oil companies.

Q. Anybody from Humble tell you that?

A. I am sure somebody must have talked about it. I had to ask for that information, so we must have talked about it.

Q. Who would you have talked to with Humble that you would indicate would have told you that?

A. Any one of the people in the Tax Department that I talked to.

Q. But you don't know who?

A. I can't pinpoint a specific time that I talked about it.

Q. But you don't know the individual's name either?

A. No.

Q. Now if none of the natural gas of the E and P Department reached the refinery for conversion to new products, would you consider the income from sales after a gas plant or after a separator to be allocable or apportionable?

A. I would have to know what you are talking about, what activity at this gas plant. It seems to me the separator—that is close proximity to the well, and the sale can be made at that point, and I believe we have allowed those as nonapportionable following situs. I think we only had the two situations, either the sale in effect at the lease or the sale after the gas plant, which is very nominal amount of gas, as I recall.

Q. Well, now, if none of the natural gas reached the refinery for conversion to new product, wouldn't you consider that that should have all been treated as situs income?

A. I think we would have.

Q. Whether or not it went through a gas plant?

A. No, I would want to know what happened when it went to the gas plant.

Q. And you really don't know what happened when it goes through a gas plant, I take it?

Mr. Timken: We will take another ten minutes.

(Recess)

Mr. Timken: Back on the record. You may continue, Mr. Ragatz.

Examination

By Mr. Ragatz:

Q. Mr. Sheridan, I believe the distinction that you made in your testimony on January and that the department makes is that the income from an oil well is recognized as similar to that of a mine for purposes of the requirements of Section 71.07 Sub 1, that income be allocated to situs I believe to the extent that it's sold off at or closed to the well head, is that a correct statement?

A. To outsiders, yes.

Q. And the statute I believe says income that is derived from the situs operation is to be allocated as opposed to apportionment?

A. Yes, we call it nonapportionment.

Q. Well, there is no reference, is there, in the statutes to a distinction between raw crude oil and refined crude oil as to what is situs income?

A. I don't believe in the statutes.

Q. There is no reference in the manual which is Exhibit 11-10-A to that distinction, either, is there?

A. I don't believe so.

Q. And there are not published rules and regulations as to that distinction either, are there?

A. Are you talking about the difference between raw crude oil—

Q. And the distinction that you draw that raw crude oil is income allocated to situs and refined crude oil is apportionment income?

A. I don't believe there is any published rule.

Q. And the manual that you—a portion of which you have in your hand is not a published document anyway, is it.

A. I don't believe so.

Q. In making a definition of that distinction I should have said the distinction is between raw crude oil and crude oil that goes through a refinery. That is where you draw the line, I believe, isn't it?

A. Yes.

Q. And as I understand it, the Department takes the position that if the crude oil goes to that refinery, that it is no longer considered as income from mining allocable to situs?

A. Correct.

Q. And the Department refuses to recognize the value of the crude oil at the well head that is transferred to the refinery as income from situs?

A. Correct.

Q. Instead it includes this apportionment income?

A. Yes.

Q. Now, who originated this distinction?

A. It's before my time.

Q. You don't know?

A. No, I don't know.

Q. And there are no published rules or regulations which explain it?

A. I don't know of any.

Q. Now, you applied an apportionment formula in the course of your audit that differed somewhat from the three factor statutory formula, didn't you?

A. No.

Q. Is your testimony that the formula that you applied is identical to the three factor statutory formula?

A. Yes, it is.

Q. What is the denominator of the formula you used?

A. Total company sales—of which factor?

Q. I am talking about the denominator of the fraction.

A. Of the sales factor?

Q. No, I am talking about the overall formula.

A. The formula is made up of three factors, the ratio of Wisconsin tangible property to total apportionment property and the cost of manufacturing and sales.

Q. And then you combined these three into one?

A. One percent, yes.

Q. And when you made the calculation to combine this, what did you use as a denominator in your fraction?

A. Well, we weighted cost of manufacturing.

Q. The statute doesn't say anything about weighting, does it?

A. I don't believe the statute says it.

Q. And the statute calls for three factors of which would make a denominator of three, isn't that correct?

A. In a normal situation, yes.

Q. And you used a denominator of something less than three?

A. Yes.

Q. And there are no rules or regulations that have been prescribed and published explaining weighting?

A. I think it does in the Kroger case. It does in the old rules of the Department.

Q. That are no longer—

A. Not in print.

Q. —in effect and print?

A. Right. It is in the Kroger case.

Q. But the Kroger case is not a rule?

A. No.

Q. And the Kroger case was not prescribed by the Department, I take it?

A. I don't understand your question.

Q. The statute says that rules and regulations prescribed by the Department. I trust the Department is not prescribing the Tax Appeals Commission decisions?

A. I don't think I understand your question here. The Kroger company is a case.

Q. In response to my question as to whether or not there are rules and regulations, you mentioned the Kroger case which is really unresponsive. The Kroger case is not a prescribed rule or regulation, is it?

A. Correct.

Q. Now, in the application of the factors in your audit you didn't really use the cost of manufacturing factor, did you?

A. Yes.

Q. Now, there wasn't any manufacturing by Humble in Wisconsin during the years in issue, was there?

A. No.

Q. So that the numerator of that portion of the three factor formula would be zero?

A. Right.

Q. And the denominator would be the total of all costs of manufacturing company-wide?

A. Right.

Q. And the denominator, when you combine the three factors, would be three?

A. No, because we have weighted that factor.

Q. And what did you use to arrive at a weight?

A. We used a ratio of apportionment sales less sales of purchased manufactured products of other vendors.

Q. But you used the sales figures, didn't you?

A. This was just in lieu of partly having manufacturing figures.

Q. But you did not use the cost of manufacturing figures as such, did you?

A. No.

Q. So in effect you used two sales factors of the three factors in the formula?

A. No.

Q. Now, in the course of the barrel formula aspect of your approach, you arrived at certain assumptions, and one of these assumptions is that the return on each dollar of sales is equivalent, is that not correct?

A. In the determination of the income of the E and P Department, yes. In order to try to ascertain income for this nonapportionment sales, yes, we used that assumption.

Q. Then, therefore, your assumption would also include the facts that the cost of sales would be equivalent for each dollar of sales, true?

A. I guess so.

Q. And you also used the assumption that for each dollar of investment you get an equivalent dollar of return?

A. I don't know that.

Q. Well, should I refresh your recollection from the discovery? I refer you again to the discovery deposition taken of you on January 15th at Page 76 of that transcript.

> "Question, I understand that. What I am driving at is, you are using a relationship of income—of types of income and interpolating that into investment in property for purposes of determining the tangible property factor, so that you are assuming that for every dollar of net income an equivalent amount of investment, relative investment is made in property?
>
> Answer, Well, let's say this is the method we are using to try and isolate that nonapportionable property."

Also on Page 77,

> "Question, Again you are back to the assumption that for every dollar of net income an equivalent dollar investment is involved, and that some activity does not cost the company more dollars of invest-

ment than other activity? Answer, I don't think that that has ever been established to an auditor and that is why this method has been used. Question, But that is your method? Answer, Yes, this is it."

Does that refresh your recollection?

A. We remove nonapportionable property based on that income ratio so if you want to say that's a dollar of net income to dollar of investment—

Q. In other words, you take the total property and you say that 60 per cent of this is allocable of the net income of the E and P Department is allocable, we are going to remove 50 per cent of property and only use the 40 per cent in the property factor for apportionment, is that correct?

A. We are talking about 60 per cent of the E and P property, not the total company?

Q. That's right.

A. Yes, we are doing that.

Q. But you are dividing property between that which you could consider in the factor for apportionment and that which you would consider relating to allocable income by multiplying a net income percentage?

A. Within the E and P Department, yes.

Q. And by using that percentage you are employing the assumption that for each dollar of property investment you produce the same equivalent dollar—of the same equivalent percentage of net income?

A. I don't think that we have that assumption. This was a matter in which to remove the property which we say pertains to producing nonapportionable income and in the absence of any other information this was the procedure that was used.

Q. This is the way you do it?

A. Yes, it is.

Q. Now at several places in the course of the calculation of your barrel formula, you employ the step of multiplying one ratio by another ratio, don't you?

A. Where specifically do you mean?

Q. Well, I am asking the question. Do you or don't you?

A. I can't answer if I don't know where you mean within the audit.

Q. Well, look at your working papers. We went over this in January. I don't want to delve too much on it, but you acknowledged at the time that this procedure of multiplying a ratio by a ratio was used in several points in your calculation. Do you recall that?

A. No.

Q. Well, let me refer again to the discovery deposition that I have previously mentioned, this time to Page 74, I believe.

"Question. Now then, you took the nonapportionment percentage which the footnote says was determined from a crude oil barrelage data? Answer. Yes. Question. And you multiplied one percentage times another percentage? Answer. Yes. Question. A ratio times a ratio? Answer. Yes."

I believe you also referred to that in your testimony at Page 75 and again at Page 77. Does that refresh your recollection?

A. I would like to look at the specific part of the audit report that we are talking about.

Q. You have the audit report in front of you.

A. No, I have the work papers.

Q. Well, the audit report is right here that you are welcome to. But I am more interested just in the concept. Do you acknowledge or do you deny that at several places in your barrel formula calculation you are multiplying a ratio by a ratio?

A. Well, the barrel formula could be worked out going ratio by ratio and come up with the same end product.

Q. But it wasn't, was it? You did multiply a ratio by a ratio?

A. In the audit, yes.

Q. Yes. And you were testifying truthfully on the deposition when you acknowledged that?

A. We did do it. It can be worked the other way without it, though, and come up with the same answer.

Q. Now this barrel formula is a very complicated calculation, I think you would agree?

A. Yes.

Q. Are there any prescribed and published rules and regulations explaining this barrel formula method?

A. Not that I am aware of.

Q. Are you familiar with the term posted field price?

A. Well, I think it to be the price that crude is bought and sold at.

Q. Between third parties?

A. In a given area, yes.

Q. And I believe you indicated that you note that Humble uses posted field prices for recording transfers between its E and P function and its refining function?

A. Somebody at Humble must have told me that.

Q. But you don't have any reason to doubt it?

A. No.

Q. Now I believe you have Mr. Kaspar's paper in front of you?

A. Yes. Yes.

Q. Do you recall his statements on posted field price?

A. Offhand—Okay. What's the question?

Q. Do you accept the Kaspar paper as the policy of the Department on the treatment of posted field prices?

A. I think that's what it is.

Q. Are you familiar with the Fisk formula?

A. No.

Q. Are you familiar with the publication named Platt's Oil Gram?

A. Vaguely.

Q. Do you want to describe what it is?

A. I thought it was a weekly newspaper or some publication which gave—I thought it was crude oil values, but maybe it's refined values.

Q. You don't really know?

A. No, I don't really know. I don't think I have ever seen one.

Q. Do you have any information as to the use of Platt's Oil Gram in connection with a determination of prices between refining function and a marketing function by an oil company?

A. No.

Q. You do know that Humble was organized by functional departments?

A. Yes.

Q. That there are separate functional department for exploration and production, for refining, for marketing?

A. Yes.

Q. Do you know that there were separate functional departments for marine, land management, minerals and coal and shale oil?

A. Yes.

Q. Now how did you treat the land management, the minerals and the coal and shale oil departments on their audit?

A. They were considered a part of the apportionable income.

Q. And just what do these functions do?

A. I am not certain.

Q. You are not certain?

A. I think coal and shale oil was investigationg the possibility of obtaining oil from the coal and shale oil.

Q. Do they process the coal and shale; is there a manufacturing company?

A. I don't know.

Q. Do you recall discussing this at the discovery proceeding?

A. No. Well, yeah, I think we mentioned these departments but I think I mentioned at the time I didn't recall exactly or specifically what those particular functions did. They were left in as apportionable income.

Q. They were not treated as situs operations?

A. No.

Q. And you don't know whether or not minerals and land management, coal and shale oil are or are not situs operations?

A. No.

Q. They are extracting raw materials from the earth, aren't they?

A. I am not certain.

Q. You really don't know, do you?

A. That's right.

Q. Do you recall indicating on the discovery examination that it might have been an oversight on your part not to treat land management as a situs operation?

A. May have. I would have to investigate the whole area in order to determine that.

Q. Why didn't you investigate it?

A. I don't know.

Q. And if it were determined that these were situs operations, then they will be erroneously included in apportionable income, wouldn't they?

A. Yes.

Q. In the course of your audit, Mr. Sheridan, did you attempt to make any check as to the validity and integrity of the accounting for transfer prices between Humble's E and P function and its refining function and its marketing function?

A. No.

Q. You made no test to that at all?

A. No.

Mr. Ragatz: I have no further questions.

Mr. Timken: You may step down, Mr. Sheridan.

(Witness excused.)

Mr. Timken: You may call your next witness, Mr. Ragatz.

Mr. Ragatz: The petitioner calls Mr. Kurt Kaspar.

Mr. Timken: Adversely?

Mr. Ragatz: Adversely. Thank you.

Mr. Schapiro: Our objection is a continuing one.

Mr. Timken: Objection overruled. Same ruling. Mr. Morris, do you want to put that in a motion or not?

Mr. Morris: No, I don't think I will.

Mr. Timken: Very well.

Would you come forward, please.

KURT KASPAR, JR., called as a witness, having been duly sworn under oath, testified as follows:

Direct Examination

By Mr. Ragatz:

Q. Would you state your full name for the record, please?

A. Kurt Kaspar, Jr.

Q. Where do you live, Mr. Kaspar?

A. Monona, Wisconsin.

Q. How old are you?

A. Forty-six.

Q. What is your occupation?
A. Accountant.
Q. By whom are you employed?
A. Wisconsin Department of Revenue.
Q. And for how long have you been so employed?
A. Since 1956.
Q. What did you do prior to that?
A. Served in the U. S. Navy.
Q. And prior to that?
A. Immediately prior to beginning in '56 I was a student at the University for a short while, I think one semester. Prior to that was in the service.
Q. And so from the time of graduation from college to the time you entered the service for the Department of Revenue you had no other accounting-related employment?
A. That's correct.
Q. What positions have you held with the Department of Revenue?
A. Office auditor in the corporation section—all of this in the corporation section. Office auditor, field auditor, field auditor reviewer, conferee, office audit supervisor, motor field tax supervisor, field audit supervisor in the field audit section.
Q. And what position did you have during the years 1966 through 1968?
A. I was a field auditor in 1966. In 1967 I became audit reviewer and in 1968 I became conferee of the corporation section.
Q. And what is your present position?
A. Field audit supervisor of the field audit section of the Audit Bureau.
Q. Quickly give us your educational background?
A. BBA from the University of Wisconsin.

Q. And there you had the basic course in economics required for the degree?
A. Yes.
Q. Any other courses in economics?
A. Not that I recall.
Q. Any graduate courses or seminars in economics?
A. Not that I recall. I don't think so.
Q. And no other economic training?
A. No formal training.
Q. If I remember correctly you are at CPA?
A. Yes.
Q. Do you have any other professional designations?
A. No.
Q. Have you ever practiced accounting other than with the Department of Revenue?
A. No.
Q. And you have never had any other auditing experience except with the Department of Revenue?
A. As I mentioned in the deposition, I think I audited the books of the Officer's Mess aboard ship.
Q. We will note that.
You were the assigned auditor on the initial audit of Humble for the years 1960 through 1964?
A. Yes.
Q. When was that audit assigned?
A. I don't know exactly when it was assigned. Probably in the early months of 1966.
Q. And when was the audit completed?
A. It was begun in April, on April 4th of 1966; and as I recall the report was issued on December 9th of 1966.
Q. Was this your first oil and gas audit?
A. No. It was the first audit of a major—so-called major oil company I would say, yes. There was another company that I—I don't recall if it had an Exploration and Production Operation or not.

Q. I believe on the discovery deposition you refused to identify that Company and you still refuse?

A. I didn't refuse. I would like to answer it but we are prohibited from doing that.

Q. By whom?

A. The law.

Q. And what other audits did you have after the Humble audit?

A. What other audits, by name?

Q. Well, first by number.

A. I don't have any idea. Finished Humble in 1966 and, as I said, I became the field audit reviewer in 1967 toward the end of the year. So, I am—I imagine there were several.

Q. Do you recall telling us on the discovery deposition that you audited two other oil companies after Humble?

A. Yes.

Q. Is that a correct statement?

A. Yes, along with several other multi-state corporations.

Q. I take it your current duties have nothing to do with oil and gas producers?

A. Up to this point, yes.

Q. What contact with oil and gas accounting have you had since the completion of these oil and gas audits we have just mentioned?

A. None.

Q. Now, at the discovery deposition you refused to identify these two companies that you audited after Humble. Do you still refuse?

A. No, I don't refuse. I would like to answer but I am prohibited from answering by the law.

Q. And do you refuse to give us the basis on which these companies were assessed?

A. No. I think I could tell you that. They were assessed on the same basis as Humble, as are all major oil companies.

Q. Do you refuse to give us the basis on which they had reported their income?

A. The other companies?

Q. Yes.

A. I think they all—Humble is the only company that refuses to file an apportionment so that they used apportionment.

Q. Are you familiar with the Union Oil case before the Tax Appeals Commission?

A. No.

Q. You don't know then that they are making a protest to apportionment similar to Humble's?

A. I don't know that as a fact, no.

Q. Will you at this time provide us with copies of these other audits so that we can examine and determine whether your statements there were assessed on the same basis as Humble are correct?

A. Which other audits?

Q. These other two audits that we have mentioned that you made.

A. No, I don't refuse. I would like to but I am prohibited from doing that by the law. I think that would be very enlightening.

Q. Prior to the Humble audit or actually the audit of the first oil company, what multi-state audit training had you been given by the Department?

A. Similar to Tom's. When you begin with the Department you are put through a formal training course for several weeks. Then you are assigned to a senior auditor who has a great deal of experience in auditing the bigger companies; and you work with those senior auditors for at least a year so that you have a year of training, a a year plus of training.

Q. What formal training have you had by the Department?

A. In auditing multi-state corporations?

Q. Yes.

A. No formal training in the formal classroom training other than the first several-week course.

Q. Well, with the prior witness I talked about the paper that you presented in October of 1968, which is admitted herein evidence as Exhibit 11-11. When was that paper prepared?

A. I would say very shortly before the date of presentation.

Q. How many oil company audits had you prepared prior to the preparation of that paper?

A. Those that we talked about, the two subsequent to Humble and those that I have done before, which I think was the only one, so probably four.

Q. Now, the paper is sitting in front of you there on the wtiness stand, and I ask you to open it up and thumb to the back and look at the schedules that are attached to that paper, if you would, please.

A. Any particular one?

Q. Where do the figures that appear on these schedules come from?

A. Which schedule?

Q. Well, let's start with Exhibit E, Page E-1.

A. As I recall, when I prepared this paper I used the combination of my imagination and numbers from one of the companies that I had audited.

Q. Could perhaps that company have been Humble Oil and Refining Company?

A. Yes, it could.

Q. In fact, it was, wasn't it?

A. I think it was.

Q. What familiarity did you have prior to the Humble audit with the Department's manual which has been admitted here in evidence as Exhibit 11-10 and a couple of chapters which are before you on the witness stand?

A. I had read and studied it.

Q. Including its definitions and its explanations of the mechanics?

A. I am sure I had, yes.

Q. And had you had any discussions with other employees of the Department concerning the techniques for auditing oil companies?

A. I suppose with my supervisor at the time prior to doing the audit. I may have called—talked to some other auditors who had done oil companies.

Q. Would you say it is a fair statement that an oil company audit is a new and different experience from other company audits?

A. It is a new and different experience, yes. Every audit of a multi-state company is a new and different experience. They are all different.

Q. But the application of the barrel formula and the manner in which you apply it is a very complex procedure, would you agree?

A. I don't think so. The barrel formula is rather simple to an accountant who is accustomed to working with numbers and a percentage, then it really is quite simple.

Q. Well, maybe we will give you an opportunity to explain it to us and the Commission at some point. Prior to the Humble audit, what books had you read on the oil and gas companies and/or taxation of the applicable and—the applicable concepts that relate to multi-state corporations as applied to oil and gas companies?

A. That is a long sentence.

Q. Yes.

A. I don't think—

Q. Do you understand the question? Otherwise I will re-state it.

A. Well, you talk first of oil companies and then about all companies. I suppose—I don't recall reading many textbooks on the computation of income, taxable income of multi-state corporations other than our training manual prior to the audit of Humble. Of course we always read the law and we always read the court cases and our actions are always based on what the courts have decided. That is our Bible I think.

Q. Now, in your paper that is Exhibit 11-11 there is a one-page sheet listing about four textbooks in the inside cover, and I believe you told me on discovery that those were books that you may have reviewed in connection with your oil company audits.

A. I think I did during the course of the audit and after the audit, and after the field work of that audit.

Q. Were there any other books?

A. Not that come to mind. I don't think there were.

Q. I believe you told us there were no other books?

A. That's correct.

Q. Had, at that point, you read the work by Altman and Kiesling on *Allocation of Income and State Taxation?*

A. No.

Q. And had you read an article by Mr. Kiesling published in Hasting's Law Journal?

A. No.

Q. Had you ever read anything at that point by Mr. Fred C. Allvin?

A. I don't think so. You are going back a long time. This is eight years.

Q. Well, what training had you been given with the Department in the concepts of, first, business income in Wisconsin?

A. What training had I had in the concept of determining business income in Wisconsin?

Q. Correct.

A. What we talked about, our training course, our experience as a junior with a senior auditor, and our experience then in auditing.

Q. Has there been any specific training devoted to the determination of what is business in Wisconsin?

A. I am sure during the first training course that we received—there is no doubt—several sessions devoted just to that topic.

Q. This was the oral training course?

A. The oral training course.

Q. Are there any materials you studied on this?

A. I think there were pass-outs, problems, examples, what have you.

Q. Are they still available in the Department?

A. I threw mine away a few years ago after the book came out, after this training course was put in manual form, I think I disposed of my notes from that course.

Q. At the discovery proceedings we had served a subpoena requesting copies of all documents in that area, do you recall that?

A. Yes.

Q. And to the best of your knowledge were the documents that were produced all of the documents relating to that?

A. Yes.

Q. So that what is in the manual constitutes everything that there is with the Department right now—

A. No, I probably have forgotten to talk about the auditor's conferences that are held in which papers are given, technical papers prepared by auditors who had experience with given problems. Those also constitute an available source of information for auditors.

Q. Several papers were produced—yours, Mr. Longhorn's, and I believe one by Mr. Lins. Are you aware of any other paper?

A. Certatinly.

Q. On the subject of oil and gas taxation?

A. No. Those are the three I know on oil and gas. You talk about this being my paper, as you notice, there are two authors on this. I was one of the authors.

Q. And Mr. Paul was a junior at that time?

A. No. He had audited as much as I had at this point, maybe more, so he had quite a bit of input into this paper.

Q. Had you received any specific training in the determination of what is a unitary business?

A. Formal training, no, other than our classroom training, and of course the paper by Mr. Longhorn which was presented, I think, at a conference prior to the time I began with the Department, so my only knowledge of that was to read it, and of course reading all of the court cases that deal with that issue.

Q. But you had not been instructed by the Department in the procedure for determination of what is a unitary business?

A. No.

Q. Had you been instructed by the Department in the procedure for determining what is an integral part of a unitary business?

A. No, other than what we talked about.

Q. I believe you testified that you had no oil and gas accounting training?

A. That's correct.

Q. And that you attended no oil and gas seminars?

A. I am not quite sure what you mean there. As part of when I was with the Motor Field Tax Division or unit, I attended many conferences having to do with oil and gas.

They were after the paper was written, though, so—

Q. Was that on oil and gas accounting?

A. Not accounting.

Q. Now based upon your experience, are you aware of any oil and gas companies that have E and P functions in the State of Wisconsin? E and P activities in the State of Wisconsin?

A. No, I am not.

Q. And are you aware of any oil companies that have refining facilities here?

A. Yes.

Q. Who is that?

A. I believe that is Murphy Oil Company.

Q. Are you aware of any others?

A. No.

Q. Have you audited Murphy Oil Company?

A. No.

(Hearing adjourned, 4:25 p.m.)

STATE OF WISCONSIN

WISCONSIN TAX APPEALS COMMISSION

Docket No. I-3806

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),

Petitioner,

- vs -

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

CERTIFICATION

KAREN A. CHERRY
MINDLA COMINS
LORETTA PETERS,

hereby certify that as the duly appointed reporters, we took in shorthand the testimony and proceedings had in the foregoing matter on the 2nd day of October, 1974, and that the attached is a true and correct transcription of said shorthand notes and of the whole thereof.

Dated this 2nd day of October, 1974.

Karen A. Cherry
Karen A. Cherry
Mindla Comins
Mindla Comins
Loretta Peters
Loretta Peters

TRANSCRIPT OF PROCEEDINGS in the above-entitled matter held before the Wisconsin Tax Appeals Commission, in Room 229, City-County Building, Madison, Wisconsin, on the 3rd day of October, 1974, commencing at 9:45 in the forenoon.

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Mr. Timken: Back on the record. Mr. Kaspar, you have already been sworn.

KURT KASPAR, recalled as a witness, having been previously sworn under oath testified as follows:

Examination

By Mr. Ragatz:

Q. Mr. Kaspar, who in the Department originally formulated that approach to the audit of multi-state gas companies?

A. The barrel formula?

Q. The whole overall approach including the barrel formula?

A. I don't really know. That happened long before my time.

Q. Now, who is credited with the development of the methods and procedures of auditing oil companies?

A. I don't know if any one person is.

Q. How about Lins?

A. He was an auditor that audited many oil companies years ago, as I understand it.

Q. Do you recall telling us on discovery that he was at least thought to be the leader in the development of this audit approach?

A. I don't specifically recall that, but I could have said that; that he was one of those that was a leader.

Q. Do you know what his experience was?

A. I think the same as most of us, that he had the same kind of training and probably worked up from smaller companies into the larger companies over a period of time.

Q. Did you ever train under him?
A. No, I did not.
Q. Did you ever meet him?
A. Never met him.
Q. I take it he is no longer with the Department?
A. No. He is not.
Q. Is he still living?
A. I think he is deceased for two or three years.
Q. I believe you indicated at discovery that in auditing Humble you reviewed another set of working papers. Would you identify the company whose working papers you reviewed?
A. I don't know as I can.
Mr. Shapiro: That has been identified.
The Witness: It was the Continental Oil Company.
By Mr. Ragatz:
Q. And you used the Continental Oil Company's papers, as I remember it, as a model for your Humble audit?
A. I never used the word "model". I certainly took them along and studied them and the barrel formula was used in the audit so that was the first time I had seen that formula.
Q. And you had these work papers with you when you went to Houston to perform your audit?
A. Yes.
Q. Is it a fair statement that your schedules and your approach is patterned after the Continental work papers and the Continental audit approach?
A. No, I don't think that you can say that. The audit approach—I don't think that the audit approach was mine. The manner in which the audit report was put together was probably patterned somewhat after that audit.
Q. Now, on discovery you declined to indicate the basis on which Continental had reported its income. Do you still decline to respond to that question?

A. I don't know. How do you stand in that area? Frankly, first of all, I don't recall how they reported it so I don't think that I can answer that question. How they filed their return, I assume is your question. I don't remember how they filed their return.
Q. Did your audit approach on Humble differ from the audit approach on Continental?
A. The audit approach?
Q. The method you used to arrive at the assessment?
A. Basically I would say it was the same, but expanded upon. I think the audit of Continental was a much similar audit in that it didn't have nearly the activities that Humble had at that time.
Q. Now, on discovery you declined to respond to the question of what differences there were in the treatment of Continental versus the treatment of Humble. Do you still decline to answer that question?
A. Not if I am able to give you that information.
Mr. Shapiro: May it please the Commission, in its order, the Commission has decided that information relative to the Continental Oil Company audit was properly excluded under the secrecy law. I would like to submit this at this point.
Mr. Timken: You are objecting to this line of questioning?
Mr. Shapiro: We object to this line of questioning with respect to information relating to the Continental Oil Company.
Mr. Ragatz: If I might be heard on that, the line of questioning I am pursuing is designed to determine whether our client was given fair and equal treatment as compared to this other oil company, which we were told on discovery was used as a model for the audit of our client, and I think we are entitled to know that.

We are aware of that Commission's decision on the production of the Continental work papers, but I still intend to preserve the question of whether we are entitled to review that document and examine on that subject, and that is the reason I am asking the questions at this time.

Mr. Timken: We will take a break for a second.

Mr. Timken: It seems to be that Mr. Ragatz merely is doing what he did with the first witness and we will allow him to do that, and these are questions along the line that you still maintain your answer that you won't answer that question, and I think we can do that, and we will allow him to do it so he can preserve the record.

Mr. Shapiro: Yes.

Mr. Timken: That doesn't disturb our ruling on discovery, you understand?

Mr. Shapiro: I understand. I think it is appropriate for counsel of respondent to instruct the witness that information that might be contained in the Continental work papers should not be disclosed.

Mr. Timken: That was your position before and still is your position?

Mr. Shapiro: Yes.

Mr. Timken: Well, you may continue.

By Mr. Ragatz:

Q. Mr. Kaspar, what years were involved in the Continental audit?

A. I don't remember, but I think that audit covered years, several years earlier than the years I was doing with Humble; as I was doing 1960 through 1974 with Humble, Continental may have covered the middle years of the 1950's.

Q. At least that audit had been completed prior to the start of your Humble audit?

A. Yes.

Q. Continental is a multi-functional oil company?

A. As I recall it was, yes.

Q. Who was the auditor on the Continental audit?

A. John Leidiger.

Q. Do you still refuse to provide us with copies of the audit report and audit working papers on the Continental audit?

A. Yes, although I don't know. That question puzzles me because I really have no control over these papers. These aren't mine to give or not to give.

Q. But they were a part of the subpoena that was served on you by stipulation for respondent upon the discovery examination?

A. They were served on me.

Q. It was in effect served on you and the other witnesses by stipulation and you as agent of the Department of Revenue would have to respond to the subpoena if the Commission directed that that was a subject proper for exercising the power of the subpoena?

Mr. Shapiro: May I say at this point that the Continental work papers are in the possession of the Department and that they are considered to be privileged documents, it is our position.

Q. Who was your supervisor at the time the Humble audit was assigned?

A. David F. Garno.

Q. And what was his position?

A. I believe he was chief auditor of the Corporation Section.

Q. And who did he directly report to in the chain of command?

A. John Leidiger at that time, at the time of the assignment of the audit.

Q. And what was Mr. Leidiger's position?

A. Section chief of the Corporation Section.

Q. What instructions were you given at the time the Humble audit was assigned to you?

A. I don't recall that there were any written instructions. Probably verbal instructions since I was, as I said, in the Madison office where the audit was assigned, instructions to go down and do the audit, look into the returns filed, determine if they were filed on a correct basis and to recompute the income as it should be, if they were incorrect.

Q. Were you told that Humble was a prime candidate for change to the apportionment method?

A. I don't recall being told that.

Q. You don't deny that, though?

A. I don't deny it.

Q. Did you confer with Mr. Garno or Mr. Leidiger during the course of your audit on Humble?

A. Yes, many times.

Q. On what subjects?

A. Probably dozens, all important subjects. The most important being what basic method to use to compute their income; and prior to that, whether or not the company was unitary.

Q. What instructions were you given as to how to determine whether or not the company was unitary?

A. Well, I was always instructed to follow the guidelines set forth in the one paper that we have referred to prepared by Mr. Longhorn.

Q. You are referring to the paper which I believe is Exhibit 12-B in this proceeding?

A. I don't know the number.

Q. I show you what has been admitted into evidence as Exhibit 12-B and ask you if that's the paper you are referring to?

A. It is. In addition to that, of course, we were instructed to follow the—any procedures or guidelines given in the training manual. We are always instructed to look

into the activities both within Wisconsin and without Wisconsin to see how Wisconsin fits into the overall picture in order to test the various unitary concepts that are involved.

Q. How thoroughly did you follow that outline contained in Mr. Longhorn's paper?

A. As thoroughly as it was possible.

Q. I see. And that would all be laid out in your work papers?

A. I think we covered that in the pretrial hearings that most of it is, some of it is not. I found that it was very difficult to obtain information about exactly how the operations in Wisconsin were conducted. I asked for that information repeatedly. Unfortunately, I didn't record those requests in the work papers, as you know.

During my first visit at Humble we had quite a long talk with the state tax manager of Humble. At that time I told him that I would be auditing the returns of Humble first to determine if the return filed was correct. And to do that I would have to look into the unitary nature of business and that I would need a great deal of information in that area. Mr. Heidner was the manager of the State Tax Department and he said he would get me what he could.

Q. Isn't it a fact that your working papers really do not reflect whether or not you asked him many of the questions contained in the outline procedures of the Longhorn paper?

A. That's correct.

Q. Now you mentioned that your first job was to determine whether the returns as filed were correct. Did you make a specific examination of the tax returns on the separate accounting basis on which they were filed?

A. Well, first I attempted to look into the unitary nature of the business, of course, to determine whether

or not it would even be necessary to examine the return as filed. If it's unitary the return as filed was meaningless also as we all know.

Q. Well, you haven't yet answered my question. Did you or did you not make a separate accounting and examination?

A. I made some tests of the returns as filed.

Q. And I believe you testified on discovery that you audited the reported sales back to the print-outs and you accepted them as filed?

A. That's correct.

Q. So they actually reflected the gross revenues from Wisconsin activities as far as you could determine?

A. So far as I could determine from the print-outs.

Q. And you have no basis to challenge the amount of sales reported in the State of Wisconsin?

A. That's correct.

Q. And I believe you also said that you traced back the cost of sales?

A. I don't recall if I said that I traced back the cost of sales.

Q. And you found no basis on which to challenge the reported cost of sales figures?

A. I did say that and that disturbed me since I said that.

Q. My question was did you say that on the discovery proceedings?

A. Is it in the proceedings?

Q. Would you like me to read it back to you?

A. Yes, if you would like to.

Q. This is the transcript of a discovery proceeding which was taken on the 15th and 16th days of January, 1974. This is admitted as Exhibit 8 in this proceeding, the transcript having been made part of this record.

I refer you to Page 29 of this discovery transcript: "Question. So you found no basis on which to challenge the cost of sales figures used on the return for the purposes of a separate accounting reporting procedure? Answer. That's right."

Now I believe you said also on discovery that you were willing to accept the operating and overhead expenses; but you had also later said that you did have some questions about allocated area expenses. Now do you know which of the reported expenses were directly reflected and which were allocatd from the Chicago Region?

A. I did at that time.

Q. Let's, for example, take the 1964 return which is I believe 4 here. I am looking for operating expenses and overhead. I think I have now all of the pages of the return here for you and I ask you which of the expenses shown, first looking at Page 4 under "Other Ordinary Necessary Expenses" you might question?

A. As being what?

Q. As being other than directly reported relating to expenditures incurred in the Wisconsin operation.

A. You can't tell from that schedule.

Q. But you testified on the discovery proceedings that you had some questions on, I believe you said they were area expenses?

A. Right. As I recall my examination disclosed that many expenses of the Chicago area such as advertising, insurance, credit, administrative overhead expenses of that nature were allocated to Wisconsin on a formula basis.

Q. And did you try to verify that formula?

A. I attempted to get some information about it. I learned something about the nature of the formula and something about the expenses that were put into a pool and a part of which were then allocated to Wisconsin.

Q. And did you find that any expenses had been disproportionately allocated to Wisconsin?

A. It was my thought that the allocation could have been attacked, yes.

Q. And I believe you indicated on discovery that there were several of these area expenses that you thought fell into that category and that those area expenses totalled in the neighborhood of $800,000.

Now I ask you to turn to the front of the return and ask you to state what the return indicates as to the reported loss for the year 1964?

A. The return shows a net loss of $842,158.

Q. And isn't it a fact then that you could have disallowed all of the area expenses or virtually all of them and still not come out with taxable income for the State of Wisconsin?

A. That's correct, if that was all I did.

Q. Now I believe you also indicated that you had no questions on the sales, cost of sales, expenses for the other years in issue under your audit.

A. I had no question at the time of the last hearing. I believe I had a question at the time of the audit that I overlooked at the time of the last hearing.

Q. Now I asked you at the last hearing whether you had any questions on sales or cost of sales in the other four years of your audit and you responded that you didn't. And I would be happy to read that back to you if you would like me to do that.

A. No, you just read that and I recall that I said that.

Q. And you were testifying under oath at the time?

A. That's correct, but I wasn't testifying falsely as to my recollection.

Q. Now I believe you also indicated to me that because of the losses and the considerable margin that even if you eliminated half or more of the allocated expenses you would

still have losses, and because you couldn't challenge the sales or the cost of sales, that any way you sliced a separate accounting reporting, you would still fail to come up with taxable income for the State of Wisconsin; isn't that correct?

A. I remember my response to that, too. I said that's correct, but that's not the way you slice it.

Q. Well, then, you really have no way of saying, though, that Humble's Wisconsin operating results as reported on the basis of separate accounting do not truly reflect the activities of Humble in Wisconsin during the years of your audit?

A. I think we do.

Q. Well, you haven't given me any factual basis on which you could make a challenge to separate accounting reporting.

A. You haven't asked me for any.

Q. Well, we went through sales and we went through cost of sales, we went through operating expenses. What else is there?

A. You are talking about challenging separate accounting reporting.

Q. No, my question is that you haven't given us any factual data on a separate accounting approach that would indicate that the separate accounting figures were so incorrect that they wouldn't have produced taxable income during the years in issue.

A. I have been trying to lead you into the cost of sales which you have been avoiding.

Q. I think I read your sworn testimony on cost of sales and—

A. Yes, you have.

Q. —and I don't think that you need to take the opportunity to change your sworn testimony. If you want to do that on direct examination that will bear on the credibility of perhaps all of your testimony.

Q. Just to wind up on separate accounting, Mr. Kaspar, assuming that separate accounting were deemed an appropriate method of reporting, you really have no basis on which to challenge the separate accounting figures as reported, or at least a basis sufficient that would have put the taxpayer in a profit position in the State of Wisconsin during the years of your audit, do you?

A. That is a question impossible to answer, Mr. Ragatz.

Q. All right, then don't try.

A. I can explain why it is impossible.

Q. You can have your chance on direct examination. Now during Mr. Sheridan's audit did you have any contacts with him?

A. I believe not—nothing in a formal nature at all. There may have been a conversation informally in the office when he was in for other reasons, there may have been a telephone conversation, but I don't recall them.

Q. Do you know whether or not he used your paper that is Exhibit 11-11 in this proceeding?

A. I assume he did.

Q. You indicated yesterday that your co-author of that paper had at least as much oil and gas auditing experience as you had, is that correct?

A. I believe that is correct, yes.

Q. And according to my mathematics, that means he had at least four or five oil gas audits?

A. Yes, I couldn't verify the number. As I recall, he began auditing oil companies before I did, but you can get that information from others.

Q. That is a fair statement that between the two of you there may have been ten or more oil and gas audits behind you at the time that that paper was prepared?

A. Yes, and of course in the preparation of that paper we weren't working in a vacuum. We were working with our supervisor, our section chief, and with others who had audited other oil companies.

Q. Did John Leidiger contribute to the effort?

A. No, I don't think so. He was no longer with us at that time.

Q. Did Carl Hoel contribute?

A. I am sure that we discussed our thoughts with him, and they wouldn't have put something in a technical paper if we didn't think it was approved by the Department, that that approach was approved.

Q. Did Dave Garno participate in the preparation of that?

A. In the same manner as Carl I am sure.

Q. At the time that paper was prepared, the two authors plus other people contributing had a pretty fair—had a pretty fair opportunity to find out how oil companies do things and how the industry worked, hadn't they?

A. We had had some experience. I think we—yes, we had had some experience.

Q. And that paper, I believe you indicated on discovery, represents now the policy paper of the Department on auditing oil and gas?

A. I have no idea.

Q. Who requested the preparation of the paper?

A. It was either Carl Hoel or Dave Garno.

Q. In your paper you indicate that posted field prices are arms' length prices determined in the field. Do you know whether posted field prices are used in valuing the interest of royalty owners in gas and oil brought out of the ground?

A. I have no idea.

Q. You don't know that?

A. I would guess that it might be considered.

Q. Did you make any investigation or examination of that in the course of your audit?

A. When you speak of, are they used in valuing the interest of royalty owners as oil comes out of the ground, are you speaking of the valuation of crude oil as it comes out of the ground?

Q. You are aware, I am sure, that much of the oil and gas produced is produced on property owned by others or in which others have reserve royalty interests or working interests?

A. There is a myriad of those interests.

Q. And those others are unrelated third parties?

A. That is—

Q. And the others are looking for the most value they can get out of their interest in the property?

A. I would think so.

Q. I repeat my question; are you aware that posted field prices are used in evaluating the interest of the third party royalty owners?

A. No, I am not.

Q. You don't know that. Are you aware as to whether the posted field prices are used in evaluating the interests of third parties, only working interests in the wells and other interests?

A. Is that a different question from your previous one?

Q. Yes, because working interests are different than your previous one?

Q. Yes, because working interests are different than royalty interests.

A. Well, the answer would have to be the same for all of the interests. I am not aware of how any one interest is computed by any given person. I suppose they can all do it differently.

Q. Are you aware as to whether posted filed prices are used in determining depletion deductions?

A. I think they are.

Q. Are you aware that those posted field price determined values are accepted by the Internal Revenue Service?

A. No, I am not.

Q. Are you aware—

A. Wait a minute. I assume they are because I believe that depletion is based on profit and is limited to profit at the well head or at a lease so they are no doubt considered and approved in some manner.

Q. Are you aware that the posted field price determined values are used for the purposes of calculating severance taxes to the various producing states?

A. No, I am not.

Q. I presume you are not aware that the producing states accept these values as determining posted field prices?

A. I am aware that the posted field price has a wide range of usages.

Q. Did you make any audit verification of severance taxes?

A. No.

Q. Isn't a severance tax a deduction in arriving at Wisconsin base income for the exploration and production department?

A. I would think it would be.

Q. You did accept the internal integrity of the E and P department's net income by using that figure as one of the base figures in your audit, didn't you?

A. I think, yes.

Q. Now did you verify the integrity of the transfer prices used by Humble in transferring crude oil and natural gas between its E and P department and its Refining department?

A. Did I verify—

Q. Yes.

A. In what way?

Q. Well, did you make an audit verification as to whether the prices used were the third party posted field prices?

A. No, I did not.

Q. Did you make an audit verification as to the prices used on the transfers of product between Humble's Refining Department and its Marketing Department?

A. No, I did not.

Q. Are you familiar with the Fisk formula for evaluating the value of natural gas?

A. No.

Q. Are you familiar with the Platt's Oil Gram publication?

A. No.

Q. I take it you made no inquiry whatsoever as to transfer prices between the Refining Department and the Marketing Department?

A. I am sure I did.

Q. You did make an inquiry?

A. I am sure we discussed it. That would be an important item to discuss at one point and to arrive at a conclusion as to whether you want to accept the company figures.

Q. Apparently you did accept the company figures?

A. Obviously.

Q. I take it that you also accepted the company's figures on royalties paid and working interest paid?

A. Yes, we did.

Q. And on severance taxes paid?

A. Yes. As I explained at the prior hearing, one year of auditing a multi-state unitary business that when the percentage of that business income taxable to Wisconsin is less than 1 per cent, any given expense really isn't very important.

You can have $500,000 tax deduction and if you multiply that by two-tenths of one per cent, the result is not very large so as a practical audit procedure it is not very practical to challenge the various individual expenses unless you can find them to be large enough to be significant.

Q. You had no basis for challenging any items?

A. No basis.

Q. And you did look at these items as part of your audit?

A. That's correct.

Q. Did you find any basis for challenging the calculations of the taxpayer's federal depletion?

A. I don't believe I even looked at it since federal depletion is not deductible on the Wisconsin return.

Q. But you did have to figure that in your formula to arrive at the Wisconsin basis, didn't you?

A. We used it to reverse it out, that's all.

Q. Now, I show you what has been admitted into evidence as Exhibit 2 which is the Wisconsin audit report and notice of assessment for the years 1960 through 1964. Now, that is the document that resulted from your audit of this taxpayer, is it not?

A. Yes.

Q. And for the purposes of clarity, we have typed the figures as opposed to relying on the Xeroxed copies of your handwritten figures, but I understand counsel for respondent is satisfied that the figures have all been properly typed.

Now, I ask you to refer to Page 22 of your report entitled "Comments Regarding Nonapportionable Income" where you cite, "Income from crude oil and gas produced by the taxpayer and sold before entering the refining process is not apportionable because such net income is of the same nature as income from a mine or quarry." Is that the policy of the Department?

A. It was at that time.

Q. Now, would you please turn to Page 14 of your paper.

A. I don't have it in front of me.

Q. Now, the last paragraph on that page—and for the record this is Exhibit 11-11—indicates that, "As mentioned briefly earlier, the theory behind this treatment is the same as that applied to income derived from farms, mines or quarries."

Now, there you are referring to the same principle that I just read to you out of the audit report, aren't you?

A. Yes.

Q. That is the Department's construction of 71.07 (1)?

A. It was at that time.

Q. Then your paper goes on to read, "To the extent that products obtained from farms, mines or quarries owned and operated by a manufacturing concern are consumed or become components of end products of the manufacturing company, that portion of the net income of the farms, mines or quarries generated by these products is unitary business income. To the extent that products of the farms, mines or quarries do not enter the unitary operation; in other words, are sold in the same state as they are in when produced, the net income generated therefrom follows the situs of the property from which derived, pursuant to Section 71.07 (1) of the Statutes."

And that is the distinction that the Department made as to what income from the oil well was allocable for situs and what income was considered to be apportionable?

A. Yes.

Q. Then the test is where the product goes, I take it?

A. The test is whether the company as part of its unitary business performed any service on that product, as I understand the test.

Q. But if the crude oil, for example, is sold at the well head to a third party, it's allocable income, and if the crude oil goes to the company's own refinery, then its value is included in the apportionable income?

A. Yes.

Q. So the test is where the product goes, correct?

A. Together with what I just told you. I think we are saying the same thing.

Q. As against that conclusion, where did you make the factual determination that the various functional businesses of Humble were unitary businesses?

A. Where did I make the determination that the various functions were unitary business?

Q. Yes.

A. I attempted to make that determination while I was at Humble as I did receive much information in that regard. I think—and that information is in the work papers.

Q. Do you acknowledge that the gasoline marketed by Humble in Wisconsin was not produced by Humble's E and P Department?

A. The gasoline marketed by Humble where?

Q. In Wisconsin.

A. That is what I was told.

Q. You don't have any basis on which to challenge that?

A. That's correct.

Q. And do you further acknowledge that the gasoline marketed by Humble in Wisconsin was not refined by Humble's Refining Department?

A. That's what I was told.

Q. And as to each of these questions the same is true as to fuel oil and heating oil, isn't it?

A. No. If you recall the one statement from Humble's tax managers—I think it is in my papers—he said specifically that fuel oil and industrial oil and automotive oil was produced by Humble from crude oil produced by Humble's wells, refined in Humble's wells and sold in Wisconsin.

Q. Can you find that statement in your papers?

A. Can I find it?

Q. Yes.

A. Yes.

Q. Will you please do so.

Mr. Shapiro: Off the record.

(Discussion off the record)

Mr. Timken: Gentlemen, we will take ten minutes.

(Recess)

Mr. Timken: Back on the record. You may proceed Mr. Ragatz.

By Mr. Ragatz:

Q. Prior to the break I asked you to identify where in your working papers you indicated you had been told Humble manufactured heating oil, fuel oil. Can you now do that?

A. You asked me if I could do what? I didn't catch one word.

Q. Where you identified where you had been told that Humble manufactured heating oil and fuel oil?

A. I think this is the work paper which contains that information.

Q. Would you identify the exhibit number and the pages?

A. Exhibit number is 3, page D-13.

Q. D-13. And I am also looking at that page and that indicates that you are talking about something ten percent or less of the Wisconsin sales, correct?

A. Well, let's see what it says.

During the period 1960 through 1962 approximately 90 percent of Humble's sales were made through bulk and retail service stations, purchases are almost entirely from outsiders, the main supplier being Shell Oil Company, Jones Island. The balance of our sales consisted of fuel oil and industrial oil sales which products were manufactured by Humble. In 1963 and 1964 Humble entered into exchange agreements with Cities Service whereby we now received products from Indiana and Chicago, Illinois through a products pipeline—

Q. So what you are saying, what you are basing your statement on, is the period 1960 through 1962?

A. I didn't finish that paragraph. One more thing. Fuel oil and industrial oils are still being supplied almost entirely by Humble.

Q. But you are talking about the ten percent or less factor of Wisconsin sales?

A. Of products that they say come directly from Humble's manufacturing, that's correct.

Q. Now would you agree that from the standpoint of accounting, unrealized, derived profits, can be determined at any functional level of an oil company?

A. I suppose you could compare anything if you want it badly enough. Yes. To answer your question, yes.

Q. And you did rely on the Humble determined E and P net income or profit in your audit I believe you indicated?

A. Yes.

Q. Now isn't it true, Mr. Kaspar, that the Department concluded automatically to apply the apportionment formula of the statutes to Humble and then developed the theory on which to attempt to justify its conclusion?

A. No.

Mr. Ragatz: No further questions.

Mr. Timken: You are excused, Mr. Kaspar. Thank you.

(Witness excused)

Mr. Timken: You may call your next witness.

Mr. Ragatz: Petitioner calls Carl Hoel adversely.

Mr. Shapiro: Same continuing objection.

Mr. Timken: Mr. Shapiro, your objection is noted and overruled.

CARL HOEL, called as a witness, and after being first duly sworn, testified on oath as follows:

Examination

By Mr. Ragatz:

Q. Please state your full name.

A. Carl John Hoel.

Q. Where do you live, Mr. Hoel?

A. Stoughton, Wisconsin.

Q. How old are you?

A. Fifty-six.

Q. By whom are you employed?

A. Wisconsin Department of Revenue.

Q. How long have you been so employed?

A. Twenty-six years.

Q. What is your current position?

A. Chief of the Corporation Section of the Audit Bureau of the Division of Income, Sales and Excise Taxes.

Q. How long have you held that position?

A. Since January of 1967.

Q. What position did you have prior to that time?

A. I was Chief Auditor of the Income, Sales and Excise Tax Division.

Q. For how long?

A. From 1962 to 1967.

Q. Prior to that, what position did you have?

A. I was Chief Auditor of the Corporation Section from 1958 to 1962; prior to that time I was a field auditor for the Corporation Section from 1948 to 1958.

Q. Did you graduate from college?

A. I graduated from the University of Wisconsin in 1940 with a Major in Accounting.

Q. What other experience besides working for the Department have you had since graduation from college?

A. I was in the Navy for five years and worked in the General Accounting Department of Ohio Chemical and Manufacturing Company for two years.

Q. Did that experience have anything to do with oil and gas accounting?

A. No.

Q. Have you ever practiced accounting?

A. No.

Q. Have you ever had any other accounting-related experience?

A. No.

Q. What was your average in college?

A. I think it was slightly above a C average.

Q. And I believe you are a CPA?

A. Yes.

Q. Do you have any other professional designations?

A. No.

Q What experience have you had with the oil and gas industry?

A. The only experience I have had was through our audits of those companies in a supervisory capacity.

Q. Have you conducted any audits of oil and gas companies yourself?

A. No.

Q. Approximately how many oil and gas audits have you served as supervisor on?

A. Well, direct supervisor between 1958 and 1962, I don't recall specifically any oil companies that were assigned at that time, but as Chief of the Section I probably signed, oh, 10 or 12 audit assessments of oil companies.

Q. When you say you signed the assessments, does that mean that you thoroughly reviewed the audit and approved it?

A. It means that I would normally review the audit report that was attached to the assessment letter. I would look at the various exhibits and schedules.

Q. Is this before or after it is prepared in final form?

A. This is when it is ready to go to the taxpayer.

Q. And do you frequently make changes in the audit report at that point?

A. I don't recall ever making any on any oil company.

Q. Have you attended any outside seminars or conferences relating to the oil and gas accounting?

A. No.

Q. And have you read any books on oil and gas accounting?

A. No.

Q. I take it then that you are not familiar with the book by Mr. Altman and Mr. Kiesling entitled "Allocation of Income and State Taxation"?

A. Yes, I am, but that isn't about oil companies specifically. That is about apportionment.

Q. Were you familiar with that at the time of the two Humble audits?

A. Yes, I think I first saw that book in about 1949 or 1950.

Q. Is that a book that you are very familiar with?

A. No, I haven't read the whole book. I have read—back then I did read sections on the unitary business and apportionment.

Q. Are you familiar with any other articles or books written by Mr. Kiesling?

A. No.

Q. Have you reviewed any articles or books written by Fred Allvin?

A. No, I haven't.

Q. Would you state your relationship to the first audit of Humble?

A. That was Mr. Kaspar's audit, right?

Q. That's correct.

A. I don't recall specifically. I may have sat in on the first informal conference. I believe I did, which was shortly after I had taken over as Section Chief. The audit had been completed, I think, prior to that time.

Q. Was Mr. Garno working for you at the time?

A. Yes.

Q. And he was the direct supervisor over Mr. Kaspar?

A. That's right.

Q. Did you review that audit thoroughly?

A. I would have had no occasion to review the audit prior to the time that the assessment notice was prepared. I would have looked over the audit report and the assessment notice before I signed it.

Q. You made no suggestions for changes?

A. Not that I recall.

Q. Is it the policy of the Department of Revenue to allow divisional apportionment of multi-functional companies?

A. No.

Q. How long has this policy been in effect?

A. Well, I would imagine since probably the early 60's, the early 1960's.

Q. And who originated this policy?

A. I think it probably came about under—when Mr. Dugan was the Section Chief of the Corporation Section.

Q. What was the rationale for that policy?

A. Well, not having participated in any of the discussions concerning that change in policy, I couldn't answer that specifically, but I assume that the way Section 71.07 (2) reads, this is not provided for in that section.

Q. Under your interpretation?

A. Yes.

Q. It is possible, though, to have more than one business in a single corporate entity, isn't it?

A. Oh, yes.

Q. And do you treat all multi-state corporations as unitary?

A. Well, I am not familiar with all of them, but I am aware of a few that have been permitted to report on separate accounting, not necessarily a divisional accounting.

Q. Would you identify them?

A. No, I couldn't do that.

Q. You refuse?

A. Well, I don't think I am permitted to under 71.11 (44).

Q. You are refusing on the basis of your interpretation of the secrecy statute?

A. Yes.

Q. So you will not allow us to examine other multi-state companies who have been permitted to report on separate accounting?

A. That is correct. As a matter of fact, I probably couldn't think of the names of any if I were permitted to answer.

Q. Would you agree, though, that a corporation having a non-Wisconsin functionally independent business should be a candidate for treatment of separating that business off, not considering that as part of a unitary business with the other operations that might be conducted in the State of Wisconsin?

A. I think that would depend entirely on the facts in the particular case.

Q. But conceptually that would be a compatible definition, a construction of the statute as you understand it?

A. Yes.

Q. Now, assuming that you could be satisfied that a divisional accounting would fairly reflect the results of operations if the divisional business were deemed unitary, would the Department nevertheless as a matter of policy refuse to accept a divisional apportionment?

A. The law provides that we may permit separate accounting, even on the unitary business, and I believe there has been at least one occasion where we have permitted the taxpayer to separate account, even though it costs the taxpayer more Wisconsin tax. He wanted to separate account for his Wisconsin operations and since we were getting more tax than we would have on the apportionment basis, we didn't have any objection.

Q. I take it your flexibility decision had something to do with the fact that you are getting more tax?

A. I don't think we would have permitted it if we had got less tax.

Q. Revenue is an influencing factor, I take it?

A. Well, I think we have to protect the interests of the State.

Q. I believe you indicated on discovery examination that you felt that Mr. Lins was responsible for the establishment of the methods and procedures to approach the audits of oil and gas companies?

A. Yes.

Q. And Mr. Lins is now deceased?

A. Yes, he is.

Q. Just for identification purposes, I show you what has been admitted into evidence as Exhibit 12-A and ask you to identify that.

A. This is a summary of a presentation that Mr. Lins gave at an auditors' conference in 1956; the subject matter of which is the determination of Wisconsin taxable income of oil companies.

Q. And the document itself is a copy of only a portion of a paper?

A. It is a summary of a paper. These were all presentations at that time and Mr. Dugan requested that each participant summarize his paper and submit it to him for distribution.

Q. And that is the same Mr. Lins that you indicated is at least credited in your mind as being the originator of that approach to auditing oil and gas companies?

A. Yes.

Q. Did he develop the interpretation that where the product goes determines whether income is allocable or apportionable?

A. Well, the particular method of allocating E and P income I believe was originated by him, but I think he was merely filing the statute.

Q. But he originated it, as far as you know that?

A. As far as I know he was the field auditor to audit oil companies after the law changed in 1949.

Q. So he first applied the tax of where the product goes as to determining whether the income is allocable or apportionable?

A. Yes.

Q. Are there any rules or regulations prescribed and published relating to an explanation of the method for auditing oil and gas companies?

A. Not to my knowledge, no.

Q. Now, I have just referred to this paper by Mr. Lins and in previous testimony we have referred to that Kaspar paper which is Exhibit 11-11. These documents are not public documents, I take it?

A. They ar not.

Q. And until our discovery proceedings in January these were not disclosed to any taxpayer, to the best of your knowledge?

A. They were not supposed to be.

Q. And they are still not published or made available to the public?

A. That's correct.

Q. Now, do the Lins and Kaspar papers still represent the policy of the Department?

A. Yes, as far as the corporation section is concerned.

Q. Now, if an auditor assigned to an oil and gas company audit is convinced that the company is unitary, is he still nevertheless charged with the responsibility of making verification of the separate accounting figures?

A. Well, I think that is up to the judgment of the auditor. I think I mentioned previously in the prior hearing that the auditor was first determined or obtained information to the extent of finding out if in his judgment whether the operation was unitary before proceeding further in the audit, and if it was determined by himself or through consultation with his superiors that we felt that the company should be changed, he would not devote time to auditing the separate accounting figures.

Q. Now, after that amendment in the statutes in 1949, the Department developed an informal policy to put all oil and gas companies on apportionment, didn't they?

A. I couldn't answer that because I wasn't—I was a field officer at the time.

Q. To the best of your knowledge.

A. To the best of my knowledge I believe that many of the oil companies automatically changed their method of reporting to the apportionment method. They were audited separately though.

Q. I believe you indicated at the discovery proceedings that after the law changed Mr. Dugan assigned audits of all the major oil companies?

A. Yes.

Q. The purpose was to put all the oil companies on the apportionment method, wasn't it?

A. I don't know what the purpose was, but these that were reporting on the apportionment method, obviously the purpose would not be to change. I am sure those who would continue to report on separate accounting—these were certainly in mind when he assigned the audit.

Q. Are you familiar with any oil companies other than Union Oil of California which is currently contesting an assessment based upon apportionment by the Department of Revenue?

A. Am I familiar with corporations—with oil companies other than Union of California that are contesting assessments based upon apportionment?

Well, I read the list of exhibits and I believe that lists Clark Oil as having something before the Commission.

Mr. Shapiro: I would like to correct that. There has been a subsequent version and that was eliminated.

The Witness: Oh, is that right?

Mr. Shapiro: Yes.

The Witness: I am sorry. Frankly, I don't know any others than what I read on the paper that I mentioned.

Q. In your current position do your responsibilities still include the citing of audit reports, the approval of audits?

A. Yes.

Q. And including oil and gas company audits?

A. Yes.

Q. And your testimony is that you are not aware of any other major oil companies contesting an assessment made by the Department of Revenue?

A. Well, I think I mentioned previously through a reorganization of the Department—about two years ago—we now have an appellate bureau that handles applications for abatement so once an assessment is involved I am not involved in the application for abatement or conferences subsequent to that time.

Q. Is your answer then that you are not aware of any other companies?

A. I am not aware of any other companies.

Q. How about Clark Oil and Refinery?

A. Well, I don't know. I may have spoken out of turn. I thought that the document that I had seen was a common effort of the petitioner and the Department's attorney, and, therefore, if Clark was mentioned on there—

Mr. Shapiro: I think the record should be clarified to this extent, the original document submitted to the respondent by petitioner's counsel included the name of that company.

The Witness: I see.

Mr. Shapiro: Subsequently negotiations were undertaken with respect to limiting the contents of that.

The Witness: I assume that any petition before the Tax Appeals Commission is a matter of public record. That is, in fact, I thought that they published the docket numbers as CCH of cases before the Commission. I may be wrong.

By Mr. Ragatz:

Q. Did you have any participation in the audit and assessment of Clark Oil and Refining Company?

A. Well, I don't know to what extent I can discuss Clark Oil at all.

Mr. Shapiro: I believe it follows the same line as the other questions propounded by counsel, that we are prohibited by law from disclosing facts relating to another company.

Mr. Timken: I think that is true, but I think he was asking whether or not he was involved in it.

Mr. Ragatz: I haven't asked for any facts yet. I may, but I haven't yet.

Mr. Timken: I would agree with Mr. Shapiro's explanation on details, but I think he can answer whether he was involved at all.

A. Yes, I am sure that I signed the assessment notice.

Q. And you are familiar with the facts that Clark has filed a petition for review before the Tax Appeals Commission?

A. This I am not positive except to the extent that I saw this on a list of companies that had filed petitions. I don't know personally that they have filed a petition.

Q. Counsel indicated yesterday he would agree to stipulate that the copy that has already been marked Exhibit 18 is a true copy of the petition on file with the Wisconsin Tax Appeals Commission of a petition for review by Clark Oil and Refining, and that the answer attached is a true and correct copy of the answer of the Department of Revenue.

A. Then I would answer, yes, it appears that Clark does have a petition before the Tax Appeals Commission.

Q. To the best of your knowledge Clark is a multifunctional oil and gas company?

A. Well, I don't believe that I can answer that under 71.11(44).

Q. You refuse to acknowledge that Clark has exploration and production and refining and marketing functions?

A. Yes.

Q. When we talked about this on discovery proceedings you indicated that there was an oil company that had E and P losses. Do you recall that?

A. Yes.

Q. And that was Clark that you were talking about, wasn't it?

A. I can't answer that.

Q. I supposed you wouldn't answer either whether your testimony at the discovery that that company's E and P operations are similar to those of Humble?

A. I can't answer that, now.

Q. And I supposed you wouldn't answer either to the facts that—strike that.

You also will refuse to make available to us the audit report and work papers of Clark Oil and Refining Corporation?

A. Yes.

Q. Is there any other public data, public records on that case that can be made available?

A. I am not aware of any in our possession.

Q. I suppose you will also refuse to acknowledge that Clark had exploration and production losses?

A. Yes, I would refuse to.

Q. And I suppose you would also refuse to acknowledge that the Department refused to allow the inclusion of these losses in Clark's apportionable income?

A. I refuse.

Mr. Shapiro: I believe counsel is testifying, giving testimony into the record by this line of testimony.

Mr. Ragatz: I am asking questions; that's all.

Mr. Timken: Objection overruled.

Mr. Ragatz: Follow up to the discussion of the general subject that we had yesterday, I am willing to offer Exhibit 8 into evidence. There is at least an appearance from the review of the public record document filed in the office of the Tax Appeals Commission that the Department policy as to the taxpayer Clark is inconsistent with its policy as to taxpayer Humble.

Without the opportunity to examine a witness who will respond, I have no way to test the consistency of the positions so at this time I offer Exhibit 18 into evidence so at least the record in this case will show what the public record shows as to the potential inconsistencies of positions as to the two oil and gas companies.

Mr. Shapiro: First, respondent submits that the counsel's statement with reference to inconsistencies is an assumption on his part. Secondly, we object to the admission on the same grounds that we did with respect to Union, on the grounds of relevancy.

Mr. Shapiro: Before we break to consider this exhibit, I think the record should show that this Commission was faced with making a decision on whether we should allow the petitioner to explore, as it needs to explore or think it needs to explore to support its constitutional case, facts that deal with other companies, other oil companies.

This Commission deliberated that question and unanimously agreed that we have to choose between the Department's position of secrecy, privilege as expressed in the statutes and the petitioner's right or its desire to show, establish possible alleged grounds for constitutional questions, and this Commission, after the deliberation, arrived at its own decision that the secrecy provision would prevail, and I want to read that into the record at this point because it has come up several times, and that was decided at the discovery procedure, and that was unanimous by the three Commissioners.

Mr. Smrz, do you wish to add anything?

Mr. Smrz: No, I don't.

(Recess)

Mr. Timken: Gentlemen, this Commission is not bound, as you know, by strict rules of evidence. Exhibit 18 is a public record by statute, so we are going to accept it, receive it in the record and overrule respondent's objection to Exhibit 18's receipt.

You may proceed.

By Mr. Ragatz:

Q. Is the policy of the Department, Mr. Hoel, to deny the apportionment of exploration and production activities of oil and gas companies if they result in losses?

A. No, I don't think that is a policy. I think we follow the same procedure with respect to E and P Departments on oil companies, all oil companies. It depends on what portion of the production goes into their own refining and what portion is sold off at the well head.

Q. It is where the product flows?

A. Specifically where the product flows as to that which flows not into their own production, what flows into the sale at the well head.

Q. You realize, I assume, that the Humble produced and refined product, that no Humble produced or refined product of crude or gasoline comes into the State of Wisconsin?

A. That has been testified to here, yes.

Q. You have no basis to challenge that?

A. No, no basis.

Q. If it could be demonstrated that a separate accounting would fairly reflect the operating results in Wisconsin of a corporation, multi-state corporation you deem to be unitary, would the Department nevertheless insist that the apportionment method be applied?

A. Generally, yes. I think the Butler Brothers case indicates that if a company's operation is unitary, you can't disprove by separate accounting that the income in a particular state was not as determined—

Q. My question was, if you could be satisfied by a demonstration that separate accounting would fairly reflect the operating results in Wisconsin, even though you might otherwise deem the corporation to be unitary, would you permit separate accounting reporting?

A. I think I testified previously that we had permitted this where the revenue of the State was not harmed.

Q. Where it was to your revenue advantage?

A. Correct.

Q. You indicated previously that after the 1949 Amendment of the Statutes, oil companies began filing on the apportionment method?

A. Some of them did.

Q. Some of them?

A. Yes.

Q. Isn't it also a fact that some of them only apportioned certain divisions?

A. That I could not answer.

Q. You don't know?

A. I don't know.

Q. I asked you on discovery examination about a procedure for separate accounting determination, and I believe you testified that you would agree if the separate accounting sales could be verified, they would be deemed reliable and reflective of the gross revenues of the particular business in the State of Wisconsin, is that a fair statement?

A. The sales, the revenue?

Q. The sales could be verified, they would then be truly reflective of the gross revenues generated by the operation in the State of Wisconsin?

A. On separate accounting—did I testify to that?

Q. Well, I can read it back to you, if you prefer.

A. Well, I don't think just the gross revenues in Wisconsin would be determinative of what Wisconsin should get under a separate accounting.

Q. Well, in terms of a correct separate accounting procedure, if the sales in Wisconsin could be verified, would you agree that the verified figure would be reflective of the gross revenues produced in the State of Wisconsin?

A. Yes, I think that follows.

Q. And I believe on discovery you acknowledged that Humble—that no Humble-produced crude oil flowed into Wisconsin and that no Humble-refined product came into Wisconsin, with the possible exception of the packaged products which are minor in percentage, do you recall that?

A. I believe that was probably testified to by your witness, so that I have no reason to disagree.

Q. I had no witness on discovery proceeding. I am reminding you that you said that, and I will be happy to read it back to you, if you don't recall?

A. I think it would help.

Q. Pardon me?

A. Please, if you would.

Q. I am referring to the discovery examination of Mr. Hoel which is dated January 16, 1974, and I am referring to Page 43 of that transcript:

> "Question: Do you know as a fact whether any Humble-produced crude oil, in fact, flows into the State of Wisconsin? Answer: I don't know for a fact. Question: What is your understanding? Answer: Well, my understanding is that there is none."

Were you testifying truthfully at that time?

A. Yes, I would have said "yes" if you had phrased this question that way, but you included refined products in your present question.

Q. Do you know as a fact that Humble—any Humble-refined product, fuel oil, gasoline, heating oil, came into the State of Wisconsin during the years 1965 through 1968?

A. I don't know as a fact, but I believe that has been testified to by other witnesses.

Q. That it did or didn't?

A. That it did not.

Q. I believe you indicated that you did know—again testifying at discovery—that a very large percentage of Humble's Wisconsin sales were from—were of products purchased from third parties?

A. That is my understanding, yes.

Q. And I believe you agree that it was a fair statement that the cost of sales under these circumstances would be very hard to challenge?

A. Certainly if they paid the specific price to somebody else and it is a matter of record, it would be hard to challenge, yes.

Q. And on this basis a gross profit determined from verified sales and third party purchases should accounting-wise provide a reliable measure of the gross profit of the corporation or of the business?

A. Accounting-wise, yes, that would follow.

Q. Okay. Then if overhead and operating expenses could be verified, the deduction of overhead and operating expenses from this gross profit would then produce from the standpoint of accounting the net profit or loss from operating that business, wouldn't it?

A. If your direct expenses—if this particular operation was exclusively Wisconsin and the direct expenses were all Wisconsin, without any allocation of expenses from outside of the State or any activities from outside of the State affecting the Wisconsin operation, that would be your net profit, yes.

Q. And if it could be shown that any expenses that were allocated from outside of the State were correctly allocated, that wouldn't change your answer, would it?

A. As I said, accounting-wise, yes.

Q. That is the way I asked it.

A. Accounting-wise, yes.

Q. Could we have five minutes?

Mr. Timken: Yes.

(Recess, 11:25—11:30 a.m.)

Q. Mr. Hoel, referring to any month multi-functional corporations, if it could be demonstrated—I mean, as opposed to the oil companies that I have already asked you about, if it could be demonstrated that a separate accounting would fairly reflect their operations in the State of Wisconsin, but nevertheless you deemed the corporation to be a unitary business, would you, as a matter of policy or would your department as a matter of policy, still refuse to accept separate accounting reporting unless it produced more revenue to you?

A. I think generally that would be our policy. I might like to add there that on a unitary business, I think the concept is that separate accounting, you cannot demonstrate that it's a fair allocation of that account.

Q. My question, though, assumes that it could be demonstrated. I am just looking for a policy.

A. On any one particular year it might be; but it could fluctuate from year to year.

Q. You do know that the only operations of Humble Oil and Refining Company in Wisconsin during the years in issue in this case were marketing operations?

A. That's my understanding.

Q. Now I believe you told me rather inadvertently that the Continental Oil working papers were those used by Mr. Kaspar on his audit.

A. I believe that's in the prior testimony.

Q. And prior to that disclosure the Continental papers or the method used in the Continental papers had not been prescribed or published in any way so the information would be available to taxpayers like our client?

A. No.

Q. Now do you view the disclosure you made of the identity of the Continental Oil Company as a violation of the statute you have been claiming?

A. Well, I think if I had to testify over again, why, I would refuse to answer or name a specific company.

Q. So you admit that you violated the statute as you interpret it?

A. Well, I don't know if that's a violation.

Mr. Shapiro: I object.

Mr. Timken: Objection sustained.

Q. Did you review Mr. Sheridan's audit and compare it to Mr. Kaspar's audit?

A. No, I didn't make any comparison.

Q. Did you review Mr. Sheridan's audit?

A. I reviewed the report before it went out.

Q. Extensively?

A. I don't recall specifically but I think on every oil company or every large multi-state corporation I looked through all of the exhibits to determine whether, particularly on the oil companies, that the treatment has been the same treatment as we have given other oil companies with respect to the E and P Department particularly.

Mr. Ragatz: Now that answer is not responsive and unless the witness is willing to answer questions so that I can test whether that is in fact true, I am going to ask that his answer be stricken from the record.

Mr. Timken: Would you read the question back, please.

(Pending questions and answers read)

Mr. Timken: Do you want to be heard, Mr. Shapiro?

Mr. Shapiro: I believe the witness responded fairly to the question.

Mr. Timken: It is the ruling of the Chair that this witness is testifying adversely. Counsel for the respondents will have the opportunity to call him as their own witness if he sees fit at a later stage.

The answer was not responsive and the answer is stricken.

The Witness: Do you want a new answer?

By Mr. Ragatz:

Q. You answered that you couldn't remember whether you had reviewed it or not, I believe.

A. The reason I qualified that is that normally I will review all reports and sign them. Now there may be a dozen reports in any one week. Now possibly I could be on vacation or on a particular day when an audit report is going out at which time David Garno would sign the assessment letter for me. Now I can't remember specifically if I signed this particular assessment. If I could see the signature on the assessment letter, then I could answer you specifically.

Q. I show you Exhibit 1 which has been admitted into evidence and the first page there.

A. Yes, that's my signature and I would have reviewed the report.

Q. Did I ask you if you had compared the Sheridan report with the Karpar report?

A. You did and I said no.

Q. You did review the Kaspar report before it went out?

A. I believe John Leidiger would have been the one to review and sign that one.

Q. You answer is you didn't?

A. If you could tell me specifically the date that Mr. Leidiger's report went out, I could answer definitely.

Q. Mr. Kaspar's report?

A. Mr. Kaspar's report.

Q. I show you what has been admitted as Exhibit 2.

A. Yes, John Leidiger reviewed that.

Q. And you did not review it?

A. I did not.

Q. Did you have any role in the audit by Mr. Kaspar by conferring or participating in conferences in connection with that audit?

A. Not to my recollection except—oh, I believe I participated in the informal conference afterwards.

Q. Are you familiar with the term "posted field price"?

A. I am familiar to the extent that the information I have received through participating in these hearings and through discussions with our auditors on matters of oil companies.

Q. And you are familiar with the discussion of posted field prices contained in Mr. Kaspar's paper which is Exhibit 11-11 herein?

A. Yes.

Q. And that paper represents the policy of the Department?

A. Yes.

Q. Are you familiar with the Fisk formula for valuing natural gas?

A. No, I am not.

Q. Are you familiar with the Platt's Oil Gram publication?

A. No.

Q. Do you have any knowledge in regard to the transfer prices used by Humble on the transfer of crude and natural gasoline between its E and P Department and its Refining Department?

A. I don't have any direct knowledge except to the extent that I believe its transfers at posted field prices adjusted for transportation.

Q. To the best of your knowledge?

A. To the best of my knowledge.

Q. And do you have any knowledge as to the transfer prices between Humble's refining function and its marketing function?

A. No.

Q. Now from an accounting standpoint would you agree that unrealized, derived profits can be determined at any functional level?

A. Yes, accounting-wise.

Mr. Ragatz: No further questions.

Mr. Timken: You are excused, Mr. Hoel.

Gentlemen, it is very close to lunch. We will break until 1:30.

(Noon recess, 11:45 a.m.)

Mr. Timken: Back on the record. Mr. Ragatz, you may call your next witness.

Mr. Ragatz: Petitioner calls John Leidiger adversely.

Mr. Timken: Same objection?

Mr. Shapiro: Same objection.

Mr. Timken: Objection overruled. Your objection is noted.

JOHN LEIDIGER, called as a witness and being duly sworn under oath testified as follows:

Direct Examination

By Mr. Ragatz:

Q. State your name for the record.

A. J. Kilan Leidiger.

Q. Where do you live?

A. Madison.

Q. How old are you?

A. Fifty-one.

Q. What is your occupation?

A. I am an Administrator with the Wisconsin Department of Revenue.

Q. How long have you held this position?

A. My current position about a year and nine months.

Q. What position did you have prior to that time?

A. Director of the Bureau Field Operations for four years, 1968 through 1972.

Q. And prior to that?

A. Prior to that I was a specialist assistant to the Secretary of Revenue from the year 1967.

Q. Prior to that?
A. Director of the Corporation Taxation section.
Q. For how long?
A. August, 1964 through December of 1966.
Q. And prior to that?
A. Field auditor for the Corporation Taxation section.
Q. For how long?
A. Approximately 15 years.
Q. Does that go back to the commencement of your employment with the Department?
A. Yes, it does.
Q. What year did you commence that employment?
A. 1949.
Q. Where did you go to school?
A. University of Wisconsin in Madison.
Q. What year did you graduate?
A. 1949.
Q. With what degree?
A. Bachelor of Business Administration.
Q. Did you have other than the basic courses in economics required for that degree?
A. No.
Q. Have you had any other advanced education?
A. No.
Q. Have you had any other economic training?
A. No.
Q. Are you a CPA?
A. Yes.
Q. Are you currently in any professional designations?
A. No.
Q. Are you a member of any professional organization?
A. Wisconsin Society of CPA's.
Q. Any others?
A. No.

Q. Other than your service with the Department of Revenue have you had any other accounting experience?
A. No.
Q. Have you ever practiced accounting?
A. No.
Q. Starting with the time that you were director of the corporation section, will you describe your duties in that office?
A. As director of the corporation section I was responsible for all of the hiring and supervision of the audit staff as well as the clerical staff, and reviewing all completed assessments, claims for returns; all acts of the section.
Q. And this included any audits of oil and gas companies?
A. Yes, it did.
Q. As a field auditor what oil and gas experience did you have?
A. I audited approximately eight or ten oil companies.
Q. Over what period of time?
A. Probably beginning in the late 50's up until through 1963-'64.
Q. Did this include major oil companies?
A. Yes.
Q. Did this include the Continental Oil Company?
A. Yes.
Q. You were the auditor on the Continental audit that was discussed in evidence this morning during the testimony of Carl Hoel?
A. Yes.
Q. And it was your audit that was used by Mr. Kaspar then as the pattern for the first audit of Humble Oil and Refining Company?
A. He so testified.
Q. Well, you were the head of that section at the time that Mr. Kaspar's audit was done?
A. Yes.

Q. Do you know of your own knowledge whether or not he used your Continental audit?

A. I can't recall.

Q. What years did it cover?

A. I don't recall.

Q. It was completed though prior to Mr. Kaspar's audit?

A. Apparently.

Q. What participation did you have in the audit by Mr. Kaspar?

A. There was several staff conferences when the audit was in process in which I participated.

Q. Did you have any participation in the assignment of the audit?

A. No.

Q. Initially?

A. No.

Q. Who would have done that?

A. Mr. Garno.

Q. He was the one responsible for the assignment of audits?

A. Yes.

Q. How did it happen that a particular company would be assigned for an audit?

A. I would guess I am not familiar with that, but we have an index system of several hundred, probably 400 large corporations in which some information is maintained which are reviewed and some information which is less available and the needs of our people, the assignments are made.

Q. Do you know whether or not the Humble audit was assigned through that procedure?

A. I don't know how the audit was assigned?

Q. What other oil and gas company experience have you had?

A. None.

Q. Did you have any specific oil and gas accounting training?

A. No.

Q. Have you attended any outside seminars on oil and gas accounting?

A. No.

Q. Other than your participation in audits as a field auditor and in a supervisory capacity you have no other contacts with the oil and gas industry in terms of accounting?

A. That's correct.

Q. Now, prior to the first audit of Humble were you familiar with the book by Altman and Mr. Kiesling called *Allocation of Income in State Taxation?*

A. Vaguely.

Q. Just vaguely. Had you read any articles at that point by Mr. Kiesling?

A. Not that I can recall.

Q. Were you familiar at that point with anything written by Mr. Fred Altman?

A. No.

Q. Have you written anything yourself covering treatment of oil and gas companies?

A. I did a paper at the Midwestern State Association at the tax administrators' convention held in Chicago in 1973.

Q. I show you what has been marked and admitted into evidence as Exhibit 12 and ask you if that is the paper you just referred to, or a copy of it?

A. Yes, it is.

Q. I am going to ask you to refer to particular provisions in there, so I will leave it in front of you. On Page 8 of your paper you make reference to pending cases involving two oil companies. Is the first company you refer to Humble, the petitioner in this action?

A. Yes, it is.

Q. And is the second company you refer to in the second paragraph Clark Oil and Refining Corporation?

A. Yes, it is.

Q. Are you aware of any other cases pending before the Department or the Commission where questions of apportionment are at issue?

A. No.

Q. You are not aware of the Union Oil of California case?

A. Other than through prior discussion here.

Q. You don't have any personal knowledge as to that case?

A. No.

Q. You do have some personal knowledge, though, as to the Clark case, I take it?

A. No.

Q. You don't?

A. No, I do not.

Q. You wrote about it in your paper, though, didn't you?

A. I mentioned it in my paper very briefly.

Q. And you mentioned in your paper that the E and P function of Clark reported losses?

A. That's correct.

Q. And that the Department refused to apportion those losses?

A. I said we treated those losses as nonapportionable for the reason that none of the product was used in the company's refineries.

Q. Now I refer you to Page 3 of your paper, and also to the paper by Mr. Kaspar that is in front of you as Exhibit 1-11?

A. Yes.

Q. Look at the paragraph starting on the bottom of Page 3, and it reads, "To the extent that products obtained from farms, mines or quarries owned and operated by a manufacturing concern are consumed or become components of end products of the manufacturing company, that portion of the net income of the farms, mines or quarries generated by these products is unitary business income. To the extent that products of the farms, mines or quarries do not enter the unitary operation, the net income generated therefrom follows the situs of the property from which derived."

Now I ask you to look at the language on Page 14 in the last paragraph of Mr. Kaspar's paper and I ask you if Mr. Kaspar's statement there is where you got the statement which you included in your paper?

A. Yes.

Q. And that represents the policy of the Department?

A. Yes.

Q. That it is where the product goes that determines whether it is allocable or apportionable?

A. Not where the product goes.

Q. Well, products sold off at the well head I understand in terms of oil and gas accounting, and products that are crude that go to the company's refinery, is treated as allocable so it depends on where the crude goes, doesn't it?

A. No, it is a taxable transaction which is what determines this.

Q. But you are looking at it in terms of the products according to your article?

A. There is a disposal of the product at the well head in a taxable transaction.

Q. And do you know what price? Are you—

A. Based on prior discussion apparently it is posted field prices.

Q. So those sales to third parties are by posted field prices, to the best of your knowledge?

A. To the best of my knowledge.

Q. Where did you get the background necessary to make the oil and gas audits that you made?

A. Through the usual training that all corporation field auditors with the Wisconsin Department of Taxation at that time received.

Q. Was there any special training in oil and gas accounting?

A. No.

Q. Were there any written documents relating to oil and gas accounting?

A. I believe only Lins' paper which was previously referred to was available in 1956.

Q. How about the corporation manual that was also previously referred to?

A. The manual was published probably in 1966.

Q. '66?

A. '66.

Q. And where did the material for that manual originate?

A. Mr. Dugan had done most of the training for the corporation field staff, and it was his notes which were used in the preparation of the manual.

Q. Mr. Dugan prepared that?

A. Yes.

Q. Had he done any oil and gas accounting?

A. Not to my knowledge.

Q. Did you have any training under Mr. Lins?

A. No.

Q. When you performed your oil and gas audits, did you use Mr. Lins' paper?

A. The paper which is an exhibit is this—

Q. That's right.

A. No.

Q. You also made a reference to the paper by Mr. Longhorn which I believe is Exhibit 11-12-B?

A. Yes.

Q. Did you use that in connection with your oil and gas audits?

A. I don't believe so.

Q. Did you review prior audits in determining how to conduct an oil and gas audit?

A. Yes. I always reviewed the prior audit reports, prior audit work papers.

Q. Did you review prior audit reports of other than the company you were auditing?

A. Not to my recollection.

Q. Even on your first oil and gas audit?

A. I don't believe so.

Q. Now, during the Kaspar audit you indicated you may have participated in some conferences. Do you remember when these conferences were?

A. No.

Q. Do you remember what was discussed?

A. No.

Q. So you don't know whether these conferences considered the question of whether the company was unitary or not?

A. I don't recall.

Q. After the 1949 Amendment of the Statutes, isn't it a fact that the company—that the Department attempted to put all oil companies on the apportionment method?

A. I believe so.

Q. And Humble was an ideal candidae for that treatment when it came into the State in 1960, wasn't it?

A. I have no knowledge of that. In 1960 I was a field auditor.

Q. When you assumed your supervisor position in 1964, the Humble audit hadn't started yet, had it?

A. No.

Q. Do you recall any discussions in the Department or any departmental correspondence concerning the possibility of auditing Humble Oil and Refining Company?

A. No.

Q. Is it your testimony that there wasn't any such discussions, or you don't recall?

A. I don't recall.

Q. Now, what if any contact did you have with Mr. Sheridan during his audit of Humble?

A. When was this?

Q. Mr. Sheridan conducted the second audit of Humble, I believe, and I believe you know—

A. I don't believe I had any contact with Mr. Sheridan during that examination.

Q. Did you participate in any meetings connected with that audit?

A. Not that I recall. I don't believe so.

Q. Do you have any knowledge as to the internal operations of the Humble Oil and Refining Company?

A. No.

Q. You do know what posted field prices are?

A. Yes.

Q. And that they are used in the industry?

A. Yes.

Q. And do you know whether or not Humble used posted field prices as its transfer price of crude between its E and P function and its refining function?

A. Only to the extent it has been testified to here.

Q. You don't have any reason to doubt that that is a fact?

A. No, I don't.

Q. Do you know what the Fisk formula is?

A. No.

Q. Are you familiar with the publication named Platt's Oil Gram?

A. No.

Q. Are you familiar with the departmental functional organization of the Humble?

A. Only through the exhibits of this hearing.

Q. Now didn't you sign the assessment letter to Humble which resulted from Mr. Kaspar's audit?

A. Yes.

Q. I refer you to Exhibit 2 and that is your signature on the first page?

A. Yes, it is.

Q. Well, at the time you signed that what familiarity did you have with the departmental organization of Humble?

A. I can't recall.

Q. What kind of a review did you conduct before you signed that?

A. I completely reviewed the audit report and I had participated in, as has been testified in earlier, in at least two staff conferences.

Q. Did you compare the Kaspar working papers and audit report to the Continental working papers and audit report?

A. No.

Q. Did you compare to any other working papers and audit report?

A. No.

Q. Do you have any knowledge as to where Humble acquired the products they have sold in Wisconsin during the 1960's?

A. I have no knowledge.

Q. You do know that Humble had no Exploration and Production activities and no refining activities in the State of Wisconsin?

A. I knew that.

Q. Do you know at what place Humble transferred its product crude from its E and P department to its refining department?

A. No.

Q. Do you know at what place Humble transferred its refined product from its refining department to its marketing department?

A. No.

Q. Where you referred to the Longhorn paper earlier, which is Exhibit 11-12B. Does this reflect the policy of the department?

A. No.

Q. Other than the Longhorn paper and the subsequently-produced Kaspar paper and the manual, are there any other documents that describe the process of auditing oil and gas companies?

A. My speech, I suppose, here.

Q. Are there any published rules and regulations that describe the audit method?

A. No.

Q. And there are not any rules and regulations that describe the weighing process?

A. No.

Q. On the application of the barrel formula?

A. No.

Q. I take it the Continental working papers have not been made public or the methods therein have not been published or otherwise made public?

A. I don't understand that question.

Q. I said I take it that the Continental working papers have not been made public or the methods used in there have not otherwise been published or made public?

A. To my knowledge, that's correct.

Q. Mr. Kaspar indicated that you contributed to the efforts that resulted in the paper we had previously referred to that bears his name and that of a Ralph Paul. Can you describe your contribution to that paper?

A. I have no recollection as I can assume my contribution may have been a couple brief conferences, probably telephone conferences.

Q. I take it you agree with the statements in that paper?

A. Yes.

Mr. Ragatz: Do you want to give me five minutes?

Mr. Timken: All right. We will wait for five minutes.

(Short recess taken.)

Mr. Timken: Mr. Ragatz.

By Mr. Ragatz:

Q. Mr. Leidiger, as a CPA from an accounting standpoint would you agree that unrealized, derived profits can be determined at any functional level?

A. From an accounting standpoint, yes.

Q. I refer you back to your paper and again page 8, down at the bottom; and I believe there you are commenting on the Clarks case. And you say that the Wisconsin Department of Revenue will not be changing its position in this matter voluntarily. If we lose this case, it is possible that Wisconsin would treat the other oil companies in the same manner by apportioning their entire net income without creating sales of crude oil and natural gas at the well head as nonapportionable outside Wisconsin. It appears that this approach might increase the Wisconsin taxable income of most major oil companies.

Is it the policy of the Department to adopt whatever construction produces the most revenue?

A. No.

Mr. Ragatz: No further questions.

Mr. Timken: You may step down.

(Witness excused.)

Mr. Timken: You may call your next witness, Mr. Ragatz.

Mr. Ragatz: The petitioner calls Mr. David Garno adversely.

Mr. Shapiro: Same objection, if you please.

Mr. Timken: Your objection is noted, Mr. Shapiro. It is overruled.

DAVID F. GARNO, called as a witness, and after being first duly sworn, testified on oath as follows:

Examination

By Mr. Ragatz:

Q. State your full name for the record.

A. David F. Garno.

Q. Where do you live?

A. Madison, Wisconsin.

Q. How old are you?

A. Forty-three.

Q. What's your occupation?

A. I am a supervisor with the Wisconsin Department of Revenue.

Q. How long have you been employed by the Department of Revenue?

A. Over 20 years.

Q. How long have you been employed in your current position?

A. Twelve years.

Q. What did you do prior to that?

A. I was a field auditor.

Q. For how long?

A. Eight years.

Q. So if my mathematics are correct, you held two positions with the Department?

A. That's correct.

Q. And what are your duties in your current position?

A. Presently I am the supervisor of the corporation field audit unit that involves assigning audits, assisting auditors on problems. I get involved in recommending changes in laws. Those are the main functions.

Q. You assign audits, you say?

A. Yes, I do.

Q. What's your educational background?

A. I graduated from the University of Wisconsin with a BBA, accounting major.

Q. What year?

A. 1954.

Q. Was employment by the Department your first job out of college?

A. Yes, it was.

Q. It has been your only job?

A. Yes.

Q. Have you had any other accounting experience?

A. No, I have not.

Q. Other than the basic required economic course for the degree, have you had any courses in economics?

A. I took one year work in theory of taxation which I believe an economics course.

Q. While you were an undergraduate?

A. Yes.

Q. Have you had any training in economics since your graduation from college?

A. No.

Q. What was your grade average?

A. In excess of a B.

Q. Have you attended any economic seminars or oil and gas seminars since— Well, at any time?

A. No, I have not.

Q. Are you a CPA?

A. Yes, I am.

Q. How long have you been a CPA?

A. Since 1957.

Q. Do you carry any other professional ratings?

A. No, I don't.

Q. What other organizations do you belong to?

A. The Wisconsin Society of CPA's.

Q. No others?
A. None.
Q. I take it you have never practiced accounting?
A. No, I have not.
Q. And you have had no other accounting-related employment other than your work with the Department?
A. I have not.
Q. What training have you had in the audit of multi-state corporations?
A. The training has been pretty much that described by other witnesses. First of all, the oral course that Mr. Dugan gave when I was employed by the Department, and then largely experience, one year working with senior auditors and the experience gained from my own field auditing plus what I gained from supervisory work.
Q. Did you study any books or articles on this subject?
A. Not to any appreciable extent, if at all.
Q. Prior to the audit of Humble, the first audit that is, by Mr. Kaspar, had you examined or read the book by Mr. Altman and Mr. Kiesling called *Allocation of Income in State Taxation?*
A. No.
Q. Were you familiar with any articles written by Mr. Kiesling?
A. Not that I recall.
Q. Had you read anything by Mr. Fred C. Allvin?
A. No.
Q. And you don't recall reading any other books or articles or manuals in this connection?
A. No. Occasionally I may have read something in the CPA Journal, but—
Q. What experience have you had in oil and gas accounting?
A. Do you mean personally?
Q. Personally.
A. None.

Q. Did you conduct any oil and gas audits?
A. No, I did not.
Q. Your answer is negative?
A. I did not, that's right.
Q. Have you had any special training in oil and gas accounting of any nature?
A. No.
Q. Have you attended any seminars or conferences on oil and gas accounting?
A. No.
Q. And you have made no special studies of your own on oil and gas accounting?
A. About the only reading I have done is what is available in the Department.
Q. Well, specifically what are you referring to?
A. Specifically the Kaspar-Paul paper, the paper that Mr. Leidiger gave.
Q. I see. And the Kaspar and Paul paper was 1968?
A. And I might add, Mr. Lins' paper.
Q. How about Mr. Longhorn's paper?
A. That did not deal with oil and gas as such.
Q. Are you familiar with the Longhorn paper?
A. Yes.
Q. When you do an audit do you use the Longhorn paper as a check list to see if the auditor did his job?
A. We have an audit reviewer in our section. I do not get deeply involved in review work.
Q. Do you know whether the Department uses the Longhorn paper as a check list?
A. I am sure our auditors do use it. Whether or not it is used extensively in review I am not sure, but I don't think so.
Q. How about the Lins paper, what use is made of that?
A. I would guess today very little. It is a rather short paper and doesn't say a great deal.

Q. Is the Kaspar paper recognized as the official position of the Department?

A. It has been, yes.

Q. To the best of your knowledge the material contained in the Kaspar paper is true and correct?

A. Yes, although I have very little direct knowledge of it.

Q. Now, describe what function you performed in your supervisory capacity in connection with oil and gas auditing?

A. Are you referring specifically to Humble?

Q. Well, generally, first.

A. In general I determine whether or not we should assign an oil company for a field audit. That entails a review of the tax returns of various companies, of course. I recall that at one time I think I asked Mr. Kaspar to review the returns of many oil companies to determine whether or not they should be assigned for a field audit.

Q. When was that?

A. I think late in 1968, early 1969.

Q. How do you determine what companies to audit?

A. Basically it is determined on the basis of my judgment as to whether or not there are problems that merit a field audit.

Q. How do you come across a company that you make a candidate for an audit?

A. There are several ways. Number one, there may be a referral from our office unit. Number two, I mentioned that I asked Mr. Kaspar to review oil company returns, and the third was the indexation that has been mentioned in previous testimony whereby I can pull the file and review it and see if it should be audited; in other words, has the company complied with the manner in which we set up the apportionment formula in the prior audits.

Q. How does an index card on any particular company get created?

A. Many were created just to control large companies, large in dollar volume. Another method would be the result of a field audit such as in the case of Humble. We created a card after the first audit.

Q. Was there a card on Humble prior to the first audit?

A. To the best of my knowledge there was not.

Q. How did the first audit of Humble happen to be assigned?

A. The case was referred to me by an office auditor.

Q. By the name of?

A. Don Weber.

Q. When was this?

A. I believe the first time was in 1963.

Q. How did he come across this company?

A. I am not sure. I would suspect in the normal course of his auditing.

Q. Anything else special that you know of?

A. Not that I know of.

Q. The testimony—

A. Might I add that he could have gotten into it as a result of an audit of Pate, the predecessor company.

Q. Do you know whether Pate was audited?

A. I am referring to an audit of the office and I believe Mr. Weber did it.

Q. An audit office paper?

A. I believe so.

Q. For what year?

A. I don't know the years exactly, it would be certainly inclusive of the time that it was merged into Humble.

Q. Have you ever failed to assign for audit an oil company which reported on the separate accounting method?

A. Not to my knowledge.

Q. Around 1960 the Department was in the process of putting all oil companies on the apportionment method, wasn't it?

A. I can't really speak in 1960. I was a field auditor then, but from previous testimony I understand that it occurred before.

Q. I want to know from your own knowledge—let's take the time when you became supervisor, which I believe would be 1962?

A. Yes.

Q. At that time was the Department in the process of putting all oil companies on apportionment?

A. No.

Q. Had that already been accomplished at that point?

A. To a large extent, yes.

Q. Are you aware of any other oil companies besides Humble that at that point were not on apportionment?

A. No, I am not.

Q. Are you aware of any oil companies who were reporting on partial apportionment; that is apportioning some functional operations but not others?

A. Some had reported that way, yes.

Q. Are you aware of any situations where the Department has permitted that kind of reporting?

A. No, I'm not.

Q. Is it a policy of the Department to deny such reporting?

A. Yes, it is.

Q. How long has this policy been in existence?

A. I can't tell you exactly. It has been a policy for many years.

Q. Longer than you have been in the Department?

A. Very possibly I would think; I am not sure. It is possible the change in the law of 1949 may have affected this.

Q. Is it the policy of the Department to refuse to permit multi-state corporations to report on the separate accounting method?

A. Not as such.

Q. Are you aware of multi-state corporations that are permitted by the Department to report on the separate accounting method?

A. I know some corporations do, yes.

Q. Multi-state corporations?

A. Yes.

Q. In what line of business?

A. Principally contractors.

Q. On a job-by-job basis?

A. It would be certainly accounting for their jobs in Wisconsin on a separate accounting basis, yes.

Q. What other kinds of businesses?

A. That is the major one that comes to mind. There are exceptions, of course.

Q. And you can't tell me of any other types of multi-state businesses that are allowed to report on separate accounting?

A. I know we have permitted some chain stores to so report. Probably it was to our advantage. Others have been converted to apportionment.

Q. In other words, if it is to your revenue advantage you might permit separate accounting?

A. That law gives us that discretion.

Q. And you would only exercise it when it is to the advantage of gaining more revenues?

A. I believe so.

Q. Is the policy of the Department to refuse to permit functional apportionment of multi-state corporations?

A. "Functional" to me means the same as "divisional" and basically that is our policy, yes.

Q. That is your policy?

A. I believe I so answered before.

Q. Even if it could be established that the functional apportionment of a division of a company would fairly reflect its Wisconsin operations, would the Department nevertheless refuse to permit functional apportionment?

A. If we felt the company were unitary, we would deny functional apportionment. The situation, of course, arises mainly where a taxpayer—where it is to the advantage of the taxpayer to report that way.

Q. One corporation could have more than one business in the same corporate shell, wouldn't you agree?

A. In the sense you are thinking of business, yes. We think of a company as a business.

Q. The statute talks about businesses not in the same context or not synonymous with limits of the corporate shell, doesn't it?

A. As I recall, the statute talks about business in the singular.

Q. Well, I won't ask you to define the statutes, I guess. Would the Department deny functional accounting of a business that had—or a corporation that had an out-of-state business that was different and totally separate from the type of business it was engaged in in Wisconsin?

A. You said functional apportionment?

Q. Functional apportionment.

A. Very likely. Now that might be a candidate for separate accounting.

Q. Well, I am thinking of a corporation that has two separate and independent lines of business, one has nothing to do whatsoever with the State of Wisconsin, the other is operating in Wisconsin and elsewhere. What would be the policy of the Department as to such a company as to whether or not it would allow functional apportionment as to the line of business that was operating within and without Wisconsin?

A. General policy would be to require overall apportionment.

Q. Of the whole company?

A. Yes.

Q. Now if that same hypothetical company organized its two business into two wholly-owned subsidiaries, then how would you apply that policy?

A. We wouldn't be called on to apply it. We would have two separate corporations.

Q. And you wouldn't be able to tax on the non-Wisconsin business, would you?

A. By your hypothetical definition, we have got a division in Wisconsin that is a part of an operation both in and out of the State, so with respect to that part of the operation we would still use apportionment, for the separate company we could not consolidate under our law.

Q. So the only difference between my two hypotheticals is that in one case the two businesses were separately incorporated and in the other they weren't?

A. Yes.

Q. And your answer is that where they are not separately incorporated, even though they are separate and independent businesses, you would apportion the whole company?

A. Yes.

Q. Did you make the assignment to Mr. Kaspar of the audit for the years 1960 through 1964?

A. Yes, I did.

Q. Do you recall when that was made?

A. Not exactly. I can pinpoint some time between, I think August of 1964 and the time he began the audit, which apparently was in April of '66.

Q. And again, what caused you to make that assignment?

A. The case was assigned to determine whether or not this company could report on separate— properly report it on separate accounting.

Q. How had that issue been raised?

A. As I testified previously, the file had been referred to me from an office auditor.

Q. And that was a Mr. Weber?

A. Yes.

Q. Have you ever had any conferences on that case before it was assigned to Mr. Kaspar?

A. With whom?

Q. With anyone?

A. I may have discussed it with Mr. Weber, but I frankly don't recall.

Q. Wasn't Mr. Leidiger your supervisor at that time or your superior?

A. Yes, he was.

Q. Did you discuss it with him?

A. Not that I recall. Normally I do not discuss assignments with my supervisor.

Q. What instructions did you give Mr. Kaspar?

A. I don't recall giving him any.

Q. None?

A. None. I said, I don't recall giving him any.

Q. Did you give him a set of working papers to use along with his audit?

A. I don't recall doing so.

Q. Do you recall his testimony that he did use the Continental working papers?

A. Yes, I do.

Q. Who would have given him those working papers?

A. They may have been obtained through me. He might have got them on his own.

Q. You don't know?

A. I do not know.

Q. Did you tell Mr. Kaspar that the issue was separate accounting versus apportionment?

A. I don't recall. Very likely I mentioned that.

Q. Did you tell him that this company was a candidate to be put on apportionment?

A. That would follow from my previous answer, this is a very good possibility, yes.

Q. And on what information have you based that kind of a statement?

A. If I made this statement it would be based on data that had been prepared by Mr. Weber indicating there was potential tax on apportionment.

Q. How would Mr. Weber know there was potential tax on apportionment?

A. By using figures that the company reported on its separate accounting returns, and making a rough calculation of what apportionment would produce.

Q. Is that a common practice to take and make a speculative calculation?

A. It is not uncommon.

Q. What facts other than the return would he have had for the purposes of such a calculation?

A. He may have had correspondence with the company.

Q. But you don't know of any?

A. I believe there was correspondence. I don't know if it really related to the question you are asking.

Q. Well, what did it relate to?

A. I don't recall. I do remember it involved both Pate and Humble.

Q. Where would that correspondence be now?

A. If I remember correctly, it was in Mr. Kaspar's work papers.

Q. But you are not sure?

A. I am not positive. It seems to me there is some, though.

Q. If I showed you those work papers, do you think you could find it?

A. I will try.

Q. I have handed you Exhibits 2 and 3, which have been identified as the work papers of Kurt Kaspar, and I would like you to point out to me where in those work papers you find this correspondence you just mentioned?

Mr. Shapiro: Is this a good place to have a recess?

(Recess 2:30-2:40)

Mr. Timken: Back on the record. Mr. Ragatz.

By Mr. Ragatz:

Q. I think the last question related to reference to some correspondence. Mr. Garno, can you now pinpoint that correspondence you were talking about?

A. Yes. It was in the taxpayer's 1964 income tax return.

Q. You mean it was in the packet with the taxpayer's 1964 income tax return that now contains numerous documents, schedules, correspondence and so on and which has been admitted here in evidence as Exhibit 4?

A. Yes.

Q. And specifically in Exhibit 4, and you might even refer to it by the numbering that we placed in the upper right-hand corner, what document are you referring to?

A. It has a red number in parenthesis, 40.

Q. And just what is that?

A. This is a note from Mr. Weber to me dated July 16, 1963.

Q. Now how does that pertain to the correspondence you mentioned?

A. I indicated that this case might have been referred to me through office audit. You asked whether or not—how I would then determine whether to assign the case; and I indicated there was a schedule showing potential tax on apportionment. And I said that schedule might have been produced through correspondence between our office auditor and the taxpayer.

Q. And is there correspondence in this exhibit that would indicate that it had been precipitated by correspondence?

A. The correspondence came after this initial note to me.

Q. I see. But there was an office audit of Pate?

A. Pate was also involved here.

Q. And Pate had precipitated the interest in Humble, is that it?

A. I don't know which came first.

Q. Now did you or Mr. Weber check the accuracy of the separate accounting reporting as one element in deciding whether to make the assignment of the Humble audit?

A. Mr. Weber checked it for the years 1960 through 1962. He has a schedule called rough calculation, and I emphasize the word rough, showing tax liability of changed, I guess, from separate accounting to the apportionment basis of reporting.

Q. I am not sure you answered my question. Did you or he check the accuracy of the separate accounting reporting?

A. I don't know if he did and I certainly could not have checked the accuracy of it.

Q. Now reviewing the schedule that you are talking about, which is attached to the document in Exhibit 4 that's labeled Page 40, that schedule is a mere computation of what kind of revenue could be produced if this taxpayer were converted to apportionment, is it not?

A. It's a rough calculation of that for the three years mentioned.

Q. What kind of tax liability did he come up with?

A. An additional $65,435.35.

Q. For the three years?

A. Yes.

Q. Was there any element other than the potential increase in revenue for making the assignment of the Humble audit?

A. We would have been concerned, of course, whether or not the company could properly report on separate accounting.

Q. But you were concerned about the revenue aspect of this assignment too, weren't you?

A. Yes.

Q. But in order to get the revenue you had to assume somehow that you could justify a conclusion that Humble was unitary in order to get it on apportionment, didn't you?

A. Certainly. We had to—

Q. Now is it a fair statement that you made the Humble audit assignment with a preconceived notion that Humble could be changed to apportionment?

A. We certainly thought there was a possibility of this, yes.

Q. And you assumed that you could subsequently support the conclusion that Humble was unitary?

A. That was what our field auditor had to determine, whether or not it was unitary.

Q. And you assumed that you could support a conclusion that the Wisconsin operations were an integral part of that total Humble business?

A. I don't think we could make any assumptions like that. That's the purpose for having a field staff to make the determination.

Q. No. but you were anticipating the potential revenue that could be obtained if you converted Humble to apportionment, weren't you?

A. Yes, there was that possibility here.

Q. And it does appear that the motivation in Mr. Weber's calculation was to see how much revenue you could obtain, doesn't it?

A. It does appear that way.

Q. And you just anticipated that you could justify that Humble was unitary and that its Wisconsin business was a unitary part of the overall business?

A. I don't think we have to make that assumption. We assigned the case for field audit to determine that.

Q. But you assigned it with the anticipation of getting some revenue, didn't you?

A. We knew there was the possibility of getting revenue, yes.

Q. In fact, you were eagerly anticipating the opportunity to get revenue, weren't you?

A. I don't know as I like the word "eagerly."

Q. Vigorously?

A. Our auditor certainly did a good job in determining—

Q. Now I mean prior to the time it was assigned he certainly was anticipating the fact that you could pick up considerable more revenue if you put Humble on apportionment, didn't he?

A. He made a rough calculation to that effect. What he was assuming I don't know. Well, maybe I do. Let's see what he says.

Q. Yes. Let's see what he says. Would you read the paragraph I am pointing to on the document labeled 40 in Exhibit 4.

A. May I read the whole document?

Q. No. I am asking you to read this paragraph.

A. It looks like we would make a bundle of tax if we switched Humble to the statutory formula method of apportionment. See schedule.

I haven't finished the paragraph. It also appears that Humble is bleeding the Pate Division through marketing and administrative expenses. Both 1961 and 1962 of Humble have good total company profits. That's the end of that paragraph.

Q. It looks like we would make a bundle of cash if we switched Humble to the statutory formula method. That's what the memo says, right?

A. Yes.

Q. And on the basis of that memo you assigned the audit?

A. The audit was not assigned at that time. May I refer to it again?

Q. Let's look at another memo. Would you identify what that is?

A. This is another note. Well, this is identified in red number 38 in parenthesis. It's dated August 19, 1964.

Q. The other document was dated when?

A. July 16, 1963.

Q. Would you read in the document, first of all identifying to whom this document is addressed and who it is from?

A. It has the initials DFG which is me from DJ Weber.

Q. What did Mr. Weber say?

A. "You wanted the Humble Oil (99-40723) (99-3447), information. Files audits after receipt of answer to my letter of February 4, 1964.

We have a waiver of Pate for the year 1959 extended until April 15, 1965.

Humble looks like an excellent prospect for changing from the separate accounting method to apportionment.

Pate Oil Company (40-12349) was accounted by Burrough for the years 1951 to 1954."

That is the end of the statement. May I see the rest of it? Shall we introduce these other notes?

Q. It's already introduced. No, I don't need it.

Now, Mr. Weber is telling you there on his August 19, 1963 memo that Humble looks like an excellent prospect for changing from a separate accounting to apportionment, isn't he?

A. Yes.

Q. Now, the previous memo we referred to in the summer of 1963 apparently precipitated from inquiries that resulted in a letter from the Department dated February 4, 1964. That is referred to in the second memo and I note here in document 39 a letter from Humble Oil and Refining Company, so apparently this was the first memo that precipitated the events that resulted in an audit?

A. The 1963 memo?

Q. Right.

A. Yes, I believe so.

Q. So the tax memo is what set off the chain of events that resulted in the audit that attempted to convert Humble from separate accounting to apportionment?

A. Yes, and as a matter of fact, it accomplished that with a great deal of additional tax paid.

Q. And that made the Department very happy, I assume?

A. Well, we are not unhappy.

Q. Now, you recall reviewing Mr. Kaspar's work papers on that first audit of Humble?

A. After he submitted the report?

Q. Yes.

A. No, I do not.

Q. Do you recall whether he made any separate accounting examination?

A. No, I do not.

Q. Under the preconceived notion a separate accounting examination really wouldn't have been necessary, would it?

A. Are you asking for the time that the report was received?

Q. Yes.

A. I am sorry, I would like the question, a couple of questions back.

(Last two questions and answers read back)

The Witness: If we had such preconceived notion, it would not have been necessary.

Q. You indicated when we had a break—

A. I am not admitting that there was such a preconceived notion.

Q. You indicated that you wanted to correct an answer to a previous question related to divisional apportionment and I am not sure I recall specifically which question it was, but I will give you an opportunity to make that correction if you want to.

A. Yes. If I recall, you asked me if we ever permitted a divisional apportionment of any company. Is there such a question?

Q. I believe there was, a multi-state company.

A. And I did not recall at that point that we had permitted some years ago. That company has subsequently been switched over to apportionment.

Q. In line with your policies of not recognizing divisional apportionments, is that it?

A. That's correct.

Q. What role did you have in the assignment of the audit to Mr. Sheridan?

A. I assigned the audit.

Q. And what precipitated the assignment?

A. My control cards on Humble Oil and Refining Company, followup audits.

Q. When was this made?

A. In October of 1969.

Q. When did the audit commence?

A. I am not sure. I think that has been testified to before, however.

Q. Did you have a conference with Mr. Sheridan at the inception of the audit?

A. Not that I recall.

Q. What instructions did you give him?

A. According to the letter that is in evidence, I told him to be sure not to let any years out. I think that was the extent of the instructions.

Q. Again you were concerned about the revenues, I take it?

A. Yes, I was.

Q. Did you give any instructions regarding apportionment?

A. Not at that point.

Q. Did you later?

A. I don't recall having done so, no. I may have in person or by telephone.

Q. Did you give him any instructions as to verifying the accuracy of the separate accounting figures reported?

A. Not that I recall.

Q. Did you give him any instructions as to how to determine whether the taxpayer was a unitary business?

A. Not at the time the audit was assigned.

Q. Did you later?

A. If I remember correctly I suggested after the assessment was made and the appeal was in that we might want to obtain more data along these lines.

Q. After the facts?

A. Yes.

Q. In fact Mr. Sheridan really didn't make a separate accounting examination, did he?

A. I am sorry, I think I misunderstood your question.

I was referring to the unitary aspect of the business.

Q. You decided that you should make more unitary inquiries after the facts, after the audit was completed, after the assessment was made?

A. I have a recollection this was not done.

Q. I didn't hear your last answer.

A. It was not done.

Q. No further information was requested?

A. Not by Mr. Sheridan that I know of.

Q. But at this point, at the point that you made that suggestion to Mr. Sheridan the audit was completed and the assessment was made?

A. Yes.

Q. Do you recall what date you made that suggestion?

A. No.

Q. What month?

A. No.

Q. Was it after the informal conference on this case?

A. What was the date of it?

Q. May of 1971.

A. I suspect it would have been after that date.

Q. How long after it?

A. This is strictly memory. I would say probably later that year.

Q. Later in 1971?

A. Yes, possibly even after that.

Q. Do you know whether that suggestion was followed up by anyone, Mr. Sheridan or anyone else?

A. No one went back to any more data.

Q. Do you know if any inquiries were made as a taxpayer?

A. I am not sure if Mr. Sheridan had any telephone contact with the company or not after that.

Q. Well, my only purpose that an inquiry could have served would be to try to build support or a conclusion that has already been incorporated in the assessment, isn't that correct?

A. Yes.

Q. Sort of after the facts, trying to find reasons for what you had already done?

A. We believe that we had reasons for what we had one based on the prior reports.

Q. Well, you must have felt you needed more reasons or why would you suggest the inquiry?

A. Because the case is in litigation and we really didn't have an awful lot of facts for the current audit period.

Q. Mr. Sheridan didn't make any serious unitary inquiry, did he?

A. No, he did not.

Q. He didn't follow the guidelines of the Longhorn paper, did he?

A. No, I don't believe he did.

Q. He didn't get the organization of the taxpayer?

A. I am not sure. I thought he had testified that he had asked about an organizational chart.

Q. Did you find an organizational chart when you reviewed the work papers?

A. I did not review his work papers in detail.

Q. Do you recall his testimony that he could not find an organizational chart in there nor any record of the fact that he had asked for it?

A. No, I don't.

Q. Mr. Sheridan didn't really make any examination to determine whether the Wisconsin business of Humble was an integral part of its overall business, did he?

A. I believe he testified that—

Q. He testified he assumed it was, but he really didn't make an examination of that?

A. Based on accounting data he felt the company was unitary.

Q. But he didn't ask the questions that the Department recommends be asked, did he?

A. As far as I know, he did not.

Q. He didn't follow the Longhorn guidelines, did he?

A. As far as I know, he did not.

Q. And your Department does recommend that the Longhorn guidelines be followed to determine whether a company is unitary?

A. Yes.

Q. In fact, your manual, I believe it is Page 323, suggests that—do you remember that of your own knowledge?

A. Yes, I do.

Q. And that the manual does recommend the use of the Longhorn guidelines?

A. Yes.

Q. And in fact, Mr. Sheridan didn't do that, did he?

A. As far as I know, he did not.

Q. And neither did Mr. Kaspar during his audit, did he?

A. I believe Mr. Kaspar went into the unitary aspects to a great extent.

Q. Do you recall Mr. Kaspar's testimony that he really didn't pay any attention to the Longhorn guidelines?

A. No, I don't.

Q. What other efforts did you make to support the conclusions that Mr. Sheridan had come to after the audit was in?

A. None.

Q. Who made the decision that Humble was unitary?

A. Are you talking about the first or the second audit?

Q. Well, let's talk about the Sheridan audit.

A. Well, initially the auditor made the decision, I might add that the time the case was assigned I assumed it was unitary because the company had paid a tax on that basis previously.

Q. You are aware that the company paid it under protest, aren't you?

A. They had a qualifying statement to that effect, yes.

Q. So that the second audit was started with the preconceived notion that Humble was unitary, is that what you are saying?

A. Yes.

Q. And it was started with the preconceived notion that the business of the taxpayer in Wisconsin was an integral part of that unitary business?

A. Yes.

Q. Who made the decision as to Humble being unitary in the first audit?

A. I believe that was a joint decision arrived at by Mr. Leidiger, our chief counsel, Mr. Barber, and myself, and of course the auditor.

Q. Starting with the preconceived notion that you could get a bundle of tax if you put Humble on apportionment?

A. We knew there was this possibility, of course.

Q. Well, what facts do you know that make Humble a unitary business—the overall Humble operation?

A. Of my own knowledge or——or what I was told by others?

Q. Your own personal knowledge.

A. I have no personal knowledge of Humble's activities other than what is shown in their returns and what their auditors have developed.

Q. What do you believe to be the facts that support this conclusion?

A. The principal fact in my opinion is that Humble's Wisconsin operations as constituted could not function without the intervention of activities by employees of Humble outside of Wisconsin.

Q. Is it your testimony that the activities of Humble in Wisconsin could not function without the assistance of the E and P function of Humble?

A. In the manner that is (set) up, this is my opinion, yes.

Q. Well, what do you base that on?

A. Again, I am—I don't have direct facts here, but it is my impression that a good part of the product that Humble sells or sold in Wisconsin is obtained through, first of all, its crude activities of the E and P Department.

Q. Now you are aware—

A. In other words because—may I add—because of the activities of that Department, Humble is able to obtain product either through its own manufacturer or from others for sale in Wisconsin.

Q. There are lots of sources of supply. What do you base your statement on?

A. The statement I just indicated, because of the activities outside of Wisconsin, the taxpayer is getting a product to sell in Wisconsin.

Q. What activities outside of Wisconsin?

A. Well, there is the manufacture of greases, industrial oils that are sold in this state, the gasoline that is sold here, I believe that is obtained through exchange agreements which, as I understand it, gets involved in the E and P functions.

Q. What do you mean—

A. Refining.

Q. What do you know about that? What does E and P have to do with exchange agreements?

A. The taxpayer can exchange crude for crude of other oil companies to use in its refineries. This becomes part of the product then sold in Wisconsin, and through other exchange agreements I believe the taxpayer is able to obtain gasoline and home fuel oil for sale in Wisconsin.

Q. Did you review Mr. Hoel's testimony at the deposition?

A. Yes, I did.

Q. And are you aware that he testified on several occasions that he acknowledges that the exchange agreements are mere purchases and sales?

A. I believe that is true.

Q. Then I fail to understand your attempt at explaining what the E and P function has to do with the sale of gasoline in Wisconsin, and I am sure you know from at least in the prior testimony that not one drop of gasoline produced by Humble flows into the State of Wisconsin for sale, so please explain now what you feel the E and P Department has to do with the operation in the State of Wisconsin.

A. Well, I thought I just did. First of all, I should add that part of the production of the E and P Department does get into the taxpayer's refinery. Part of the product of that refinery gets into Wisconsin for sale.

Q. What kind of products are you talking about?

A. Industrial oils, greases, lubricants.

Q. Which is a very minor part of the total sales volume in the State of Wisconsin by Humble during the years in issue, wasn't it?

A. I don't know. What do you mean by "minor"?

Q. Well, did you hear the prior testimony of Mr. Sheridan that it was just a few percentage points and during Mr. Kaspar's period it might have been as much as 10 per cent?

A. Ten per cent can be a significant amount.

Q. But 90 per cent is a much more significant amount, wouldn't you say?

A. Yes, nine times greater.

Q. Now what dependence does the marketing operation in the State of Wisconsin have on the Humble's E and P function, in your mind?

A. In my mind as I have tried to say, because of Humble's E and P functions, it is able to obtain either through its own manufacturer or by exchanging with others a product that it sells in Wisconsin.

Q. Are you telling me that Humble's service stations in the State of Wisconsin wouldn't have gasoline to sell if it wasn't for Humble's E and P function?

A. They might be able to obtain gasoline in other ways, but I think this is the way it has been done.

Q. Certainly there are a lot of independent marketers in the State of Wisconsin that don't have an E and P function out of the state to back them up, aren't there?

A. I assume so.

Q. They all get gasoline?

A. Fine.

Q. Why (couldn't) Humble obtain their gasoline from somebody else?

A. I don't know if the taxpayer would permit them to.

Q. Haven't you heard the testimony that, in fact, they did get the gasoline from third parties?

A. I thought you were referring to direct purchases from third parties without any intervention from other employees of Humble, such as an independent would.

Q. Well, I am asking you right now about the E and P function and I will ask you about the refining function, and I will ask you about the marketing function, but I take it it is your testimony that you really have no infor-

mation that would indicate that any part of the E and P function made any contribution direct or indirect to the activities in the State of Wisconsin from which you could conclude that the Wisconsin marketing operations were dependent upon the E and P function? Do you or do you not have facts on that?

A. As I began this line of testimony, I told you I have no direct facts.

Q. How about the refining function?

A. As I have indicated, the refining function does produce a product that is sold in Wisconsin.

Q. A minor amount of packaged product?

A. I would not admit it is minor. I don't know if that is relevant or not.

Q. But you accept the fact that had been previously testified that 90-some per cent of the sales in Wisconsin were products bought from third parties?

A. Yes, I am not sure if it is bought or exchanged. Frankly I don't have a good knowledge of exchange agreements. I have never seen one to read.

Q. You don't deny that an exchange is a purchase and a sale?

A. I am not sure that it is.

Q. You don't know?

A. I don't know.

Q. Well, how would the Wisconsin marketing operations conceivably be dependent upon the E and P (or) refining operations as to the 90 per cent or whatever of product that was purchased or acquired from third parties?

A. Well, if the taxpayer has gasoline available or crude available, however it is working here, you are talking refinery now?

Q. I am talking refining department.

A. Okay. If for economic reasons, the taxpayer has has refined gasoline, let us say in Texas, and finds it more

profitable to dispose of that gasoline by an exchange agreement with another oil company that has gasoline available let's say in Chicago, it would be economically more feasible for the taxpayer to obtain the other company's gasoline in Chicago and sell it in Wisconsin.

Q. So they sell gasoline in Texas and they buy it in Chicago?

A. They may sell or exchange, I am not sure how it works.

Q. Well, were there—a sale is a sale, whether it is paid for in kind or in cash, wouldn't you agree?

A. If it is a sale, yes.

Q. Well, how do you define a sale?

A. A sale is a transfer of the product from one party to another for a consideration.

Q. From an (accounting) standpoint, Mr. Garno, isn't it a fact that unrealized income, net income derived, can be determined on a functional basis?

A. You are not referring to tax accounting?

Q. I am referring to generally-accepted principles of accounting consistently applied.

A. Yes.

Mr. Ragatz: No further questions.

Mr. Timken: You are excused, Mr. Garno.

(Witness excused)

Mr. Timken: You may call your next witness.

Mr. Ragatz: The petitioner calls Mr. Oral Luper.

ORAL L. LUPER, called as a witness, and after being first duly sworn, testified on oath as follows:

(Exhibits 19 A, B, C and D marked for identification)

Mr. Ragatz: We have just marked Exhibits 19 A, B, C and D which are copies of pages of the Milwaukee Journal, one taken from each of the years 1965, 6, 7, 8. And this

is an exhibit of the respondent but it will be introduced at this time (stipulating) that it is authentic, and so that the current witness can be examined on it both on direct and on cross.

Mr. Timken: Mr. Shapiro, do you so stipulate?

Mr. Shapiro: We so stipulate.

Mr. Timken: Exhibits 19 A, B, C and D are received.

Examination

By Mr. Ragatz:

Q. Would you give your full name?

A. My name is Oral L. Luper.

Q. Where do you live?

A. I reside at 11107 Meadowick Drive, Houston, Texas.

Q. How old are you?

A. I am 60.

Q. Would you briefly summarize your academic background?

A. I attended the University of Oklahoma from the years 1931 and graduated in 1936; received a Bachelor of Science degree from the School of Busines Administration in 1936.

Q. And what was your major?

A. Accounting.

Q. Did you take any post graduate work?

A. Yes, I took post graduate work at the Northwestern University in Chicago, Illinois in the years 1937-38.

Q. And are you a Certified Public Accountant?

A. Yes, in the States of Texas and New York.

Q. And how long have you been a CPA?

A. About 34 years I believe.

Q. Would you trace your private employment history after graduating from college?

A. When I graduated from the University of Oklahoma I became employed with the El Reno Mill Elevator Company in El Reno, Oklahoma, a subsidiary of General Mills, Inc.

Q. In what capacity were you employed there?
A. As an accountant.
Q. And what responsibilities did you have?
A. Primarily the maintenance of inventory records and the determination of product cost.
Q. What kind of product was this?
A. Feed. Flower and feed.
Q. And how long were you with General Mills?
A. About six months.
Q. And what was your next employment?
A. I was employed then by Price Waterhouse and Company in Buffalo, New York.
Q. And what were your duties with that employment?
A. I was a staff accountant then.
Q. And public accounting practice?
A. Public accounting practice, engaged in auditing of various companies.
Q. What kinds of businesses did you have experience auditing?
A. Oil and gas companies, airplane, electronics, utilities.
Q. How long were you with Price Waterhouse?
A. Till 1941.
Q. And what happened in 1941?
A. I entered the U.S. Armed Services.
Q. And what branch were you in?
A. In the Quartermaster Corps.
Q. And how long had you lived in the armed services, Mr. Luper?
A. From April 1941 until April of 1946, I believe.
Q. Did your work in the armed services have anything to do with your academic background or your prior experience?
A. Only in a general way.
Q. What employment did you accept upon the release from the armed services?

A. I was employed by the Humble Oil and Refining Company in Houston, Texas.
Q. And that was what year?
A. In 1946.
Q. What was your first position?
A. I was a supervisor of a systems and staff.
Q. And this related to accounting?
A. Yes, this was involved in accounting systems, financial reporting systems—all types of systems related to financial information.
Q. Now would you generally trace the different positions you have held with Humble from that time forward?
A. Well, after I believe it was in 1949 I became assistant general auditor and in 1950 I became general auditor for the company; and in that capacity I was responsible for directing new activities of the company's internal audit staff which involved the auditing of the various accounting, financial departments of the company, the auditing of the operational departments of the company, the auditing of other companies with whom we had joint ventures, the auditing of contractors which were employed on a cost-plus basis, same activities.
Q. How long did you serve in that job?
A. In 1952 I believe it was I became assistant to the comptroller and then in 1953 I became the comptroller of Humble Oil and Refining Company.
Q. Was the comptroller of Humble, as it is with many companies, the chief accounting officer?
A. Yes, it was.
Q. Would you describe a little bit the duties and responsibilities of that position?
A. As the comptroller of Humble I had responsibility for directing and maintaining the accounting systems of the company including responsibilities for the development and implementation of budgeting plans, the development

and planning and maintenance of planned work for financial reporting, the development of the systems for financial forecasting, supervision of the internal audit staff, supervision of the systems and computing staff.

Q. What was your next position?

A. In 1959 I became comptroller of a new company which is also Humble Oil and Refining Company, but this was the Humble Oil and Refining Company of Delaware. This new company came as a part of a reorganization in which the Standard Oil Company of New Jersey acquired the entire stock ownership of Humble Oil and Refining Company of Texas, the former company. And shortly thereafter the domestic petroleum companies, which were wholly owned (subsidiaries) of Standard Oil Company of New Jersey, were merged into the new Humble Oil and Refining Company of Delaware at, I believe, December 31, 1959.

Q. How long did you serve in that capacity?

A. Until 1962.

Q. Now, during that period was that the time that the subsidiary Pate Oil Company that we talked about in the stipulation in this case was merged into Humble Oil and Refining Company?

A. Yes. The Pate Oil Company was merged into the Humble Oil and Refining Company of Delaware, I believe, on June 30th or July 1st of 1960.

Q. Thereafter the business of Pate was continued by Humble?

A. Yes, it was.

Q. What was your next position?

A. I became a general manager of the (Esso) Standard Eastern Region of our Marketing Department in 1962.

Q. What were your duties there?

A. I was responsible for the marketing activities of that region.

Q. How long did you have these responsibilities?

A. Until 1963 when I became the assistant to the president of the Standard Oil Company of New Jersey.

Q. Identify the relationship between Standard Oil of New Jersey and Humble Oil and Refining at that point in time.

A. At that point in time the Standard Oil Company of New Jersey was the parent of Humble Oil of Delaware and it was a wholly-owned subsidiary.

Q. What business did the Humble Oil and Refining Company conduct during that period? Was it involved in foreign operations or was it restricted to domestic operations?

A. The operations of Humble Oil and Refining were strictly domestic operations of the United States Petroleum operation in the United States.

Q. How long did you serve in that capacity?

A. Until 1963.

Q. And then what position did you take?

A. I became the assistant to the Chairman of the Board of the Standard Oil Company of New Jersey.

Q. What were your duties there?

A. My duties there were to assist the chairman in the matters he had to consider at Board meetings, (and) executive committee meetings. I analyzed and evaluated matters that required his attention. I assisted him by providing (liaison) on communications, links between him and other members of the organization and other representatives of the subsidiary companies.

Q. When did you become a director of the Humble Oil and Refining Company?

A. In 1965.

Q. How long did you serve as director?

A. I served as director until January 1st, 1973.

Q. And that was when Humble was merged into the Exxon Corporation, the present corporation?

A. Yes.

Q. How long did you continue as the assistant to the Chairman of the Board of Standard Oil of New Jersey?

A. It was a little over a year.

Q. What was your next position?

A. Director of Humble Oil and Refining Company in 1965.

Q. And what position did you assume next?

A. I was a director of the company and later became a vice-president.

Q. What were your duties as vice-president?

A. I was responsible primarily for the financial activities of the company which embraced the general supervision of the comptroller's department, the treasurer's department, the tax department, and later the land management department. I was also responsible for certain insurance activities and later I became associated with real estate activities.

Q. And what was your next position?

A. Well, I became a senior vice-president of the Exxon Company, U. S. A., on January 1st, 1973. That was the time—on that date—the Humble Oil and Refining Company of Delaware was merged into the Exxon Corporation. The Exxon Corporation had previously been the Standard Oil Company of New Jersey. After the merger of Humble Oil into the Exxon Corporation at the beginning of 1973, the operations and activities of the former Humble Oil and Refining Company were resumed and carried on in almost an identical manner as of the Exxon Corporation, U. S. A., as a division of the Exxon Corporation.

Q. And your present position with the company?

A. At present I am Senior Vice-President of the Exxon Company, U. S. A., and a member of its management committee. The management committee was created as a substitute for the former Board of Directors.

Q. On your current position maybe you could sketch your major responsibilities.

A. In my present position?

Q. Right.

A. I am—my general responsibility is for the financial activities of the company. I am executive contact for the comptroller department, the treasurer's department, the tax department and the land management department. In addition I am the shareholder contact with two subsidiary companies, one a wholly-owned subsidiary engaged in land development activities, and the other a wholly-owned subsidiary engaged in insurance activities.

Q. In the aggregate how much time do you have in oil and gas industry in years?

A. Over 28 years.

Q. Would you describe professional societies and organizations that you belong to?

A. I am a member of the American Institute of Certified Public Accountants and a member of its Board of Directors. I am a member of the Accounting Research Association which is the research arm of the American Institute. I am a member of the Texas Society of Certified Public Accountants. I am a member of the Financial Executives Institutes. I am a Trustee of the Financial Executive Research Foundation which is the research arm of Financial Executive Institutes. I am a member and a director of the Texas Manufacturing Association. I am also a member of a number of civic and cultural organizations, and I should mention that I am a member of the American Petroleum Institute.

Q. Have you served as a member of the Accounting Principles Board?

A. Yes, I have.

Q. For how long?

A. A little over—about seven years.

Q. Could you briefly describe for me any books or articles you have written on the subject germane to the issues in this case?

A. I really haven't written any books or articles really germane to this case.

Q. How about to oil and gas accounting?

A. I really haven't—I have had some—I believe one article published in this area, but not particularly involved in this case.

Q. Would you just mention the names of the publications in which you have articles published just as part of your background?

A. Well, I have an article published in the Journal of Accountancy, (and) the Financial Executive Institute publication. I was a contributing author to the financial officer's handbook.

Q. Did you mention the Journal of Accountancy?

A. Yes.

Q. Have you held any academic positions over the years?

A. Well, at the University of Oklahoma I was an accounting laboratory instructor and when I was taking graduate work at the Northwestern University I (held) a teaching fellowship.

Q. I would like you to describe the corporate organizational structure of Humble Oil and Refining Company for the years 1960 through 1968.

(Exhibit Number 20 marked for identification)

Q. I show you what has been marked Exhibit 20 and ask you to identify that, please.

A. This is an exhibit entitled "Humble Oil and Refining Company Corporate Organizational Structure of 1960-1968." It contains a brief outline of the organizational structure.

Q. Was this prepared at your direction?

A. Yes, it was.

Q. Does it set forth (the) organizational structure during this period?

A. Yes, it does.

Mr. Ragatz: I would like to move the admission of this exhibit.

Mr. Timken: Any objection?

Mr. Shapiro: No objection.

Mr. Timken: Exhibit 20 is received.

By Mr. Ragatz:

Q. I would like you to describe, first of all, the corporate management functions shown on the exhibit.

A. Well, as you can see, or as the exhibit demonstrates, the basic organizational structure of Humble was in three parts. The corporate management was the principal, the highest order of management in the company and represented the executive management (of the) company. It was composed of the Board of Directors, the Executive Committee, the Chairman of the Board, who was also the chief executive officer, the president and the directors in charge who were members of the Board of Directors.

Q. Would you describe the Board of Directors briefly, please?

A. The Board of Directors was composed of eight members. It had the responsibility for the overall direction and operation of the company, responsible for the broad policies of the company. It elected the officers and declared the dividends, reviewed the overall goals and objectives of the company.

Q. How did the Executive Committee operate?

A. The Executive Committee—the Board of Directors has delegated to the Executive Committee all the powers of the Board with the exception of certain powers such as the election of officers, the declaration of dividends and other matters which we restricted to the Board. (That is) from a legal point of view.

Q. The Executive Committee operated in absence of the Board and on these matters?

A. Yes.

Q. And how did the Chairman of the Board fit into the organization? What were his responsibilities?

A. The Chairman of the Board was, of course, the Chairman of the Board and he was the chief executive officer of the company. As such he had the responsibility for implementing the policies and decisions of the Board of Directors. He was also, of course, the company's principal spokesman with the public at large.

(Recess)

Mr. Timken: We will go back on the record.

By Mr. Ragatz:

Q. Would you describe the responsibilities of the President?

A. The President in the absence of the Chairman of the Board acted as Chairman of the Board. He was also responsible for the overall administration of the company's activities, and in the absence of the chief officer he acted for him.

Q. How were the directors in charge designated? How was that designated? How was that carried out?

A. The directors in charge were first of course members of the full-time Board of Directors, but in addition they were the executive officers of—having general responsibilities for specified operating departments or coordination and service department.

Q. Let's move to the coordination and services, management level, and would you describe that?

A. Well, the next segment of the organization structure is referred to by us as the Coordination and Services Management, and this is composed of corporate staff departments. The responsibility of this management group, is, of course, to provide the overall specialized corporate services that are needed by the corporation overall. Their department advised the corporate officers and the Board of Directors, they advised the operation's management, and also they advised as needed the management of the other service—other staff departments.

Q. Well, let's take the various staff departments that compose the Cordination and Services Management. Would you describe the Corporate Planning Department?

A. The Corporate Planning Department was responsible for the long range planning of the company. It was responsible for assisting and developing the overall company strategies, and advised the Board in a manner to try to maximize the overall company operations, the effectiveness of the operations.

Q. How did the Secretary's Department operate?

A. The Secretary's Department provided a secretary for the Board of Directors and a secretary for the Executive Committee. The Department maintained the official corporate records, the charter and by-laws, and they provided and maintained the minutes of the meeting of the Board of Directors, and the Executive Committee, and they also were responsible for the area of executive compensation, executive development and training, and general advice in the corporate affairs of the company.

Q. How about the Supply Department?

A. The Supply Department was responsible primarily for the purchase and sale of raw crude and raw materials and acted as a coordinating group between the refining and other operation functions, so as to obtain an optimum short range operating program.

Q. Now this is not an operating department as such, though, was it

A. It was not an operating department, no. It was a—we did not consider this a profit center.

Q. Would you describe the Treasury Department?

A. The Treasurer's Department was headed by the Treasurer of the company, who had responsibility for all of the financial resources of the company, responsibile for the development of financial policy and procedures, and maintained banking relations, developed plans for the appropriate financing of the company's activities, and provided an analyses of the financing aspects of the proposed investments.

Q. And the Comptroller's Department?

A. The Comptroller's Department was headed by the Comptroller and the Comptroller was responsible for the overall maintenance of the company's accounting systems and in charge of the books of account of the company. It involved procedures and plans related to the appropriate systems of capital budgeting throughout the company providing appropriate systems for financial reporting, appropriate systems for financial forecasting, and they were responsible also for operating the computing—some of the computing centers of the company, maintaining a systems staff, and finally maintaining an overall system of internal control and responsibility for the internal audit staff.

Q. But these functions did not include the accounting for each operational function, I take it?

A. As I will explain later, the operation functions have separate accounting offices. The comptroller had responsibility for an accounting office that maintained the corporate records, the consolidated financial reports.

Q. And this is the department that you headed up for a period of time?

A. I did in the early 60's, yes.

Q. Would you describe the Tax Department?

A. The Tax Department was headed by the general tax counsel, the Department is responsible for providing tax counsel and tax advice to all departments of the company, and have responsibility for the determination of the ap-

propriate tax liability of the company to the various governmental authorities.

Q. And again this was the overall company tax liability, not the responsibilities of each operational function?

A. The Tax Department was responsible for the tax administration to the company, but some of the operation departments did have personnel in their organization to carry out the routines of some of the tax reporting requirements is all, some of the routine reports that are required.

Q. Now the Law Department?

A. The Law Department was headed by the general counsel of the company, and the Department provided legal counsel for the Board of Directors, the officers of the company, and the other management groups within the company.

Q. The Public Relations Department?

A. The Public Relations Department had the responsibility for promoting an understanding of the company's character and its goals and its performances with the general public. They were responsible for the maintaining and communication and information service to the public, to governmental authorities, the media and other outside parties.

Q. This is not the advertising function?

A. No, the advertising function was performed in the Marketing Department.

Q. Describe the Government Relations Department.

A. The Government Relations Department was responsible for coordinating the company's government relations activities, and was responsible for liaison with the government officers at the federal level and in the State of Texas.

Q. The Employee Relations Department?

A. The Employee Relations Department was primarily responsible for providing a competent and able work force within the company. They were responsible for developing plans and procedures for salaried administration and training, employee development, employment, the details of plans for employee benefits, and advice on labor relation matters.

Q. Each operating function had its own personnel people and its own labor relations?

A. Yes, they did.

Q. Describe the General Services Department?

A. The General Services Department was responsible for providing the corporation with office facilities and all of the office services such as printing and reproduction and janitorial services, the very varied services that are required for the everyday routines and operation of the corporation.

Q. Medical Department?

A. The Medical Department was concerned with the industrial hygiene of the company and advised the company on the health of the employees and provided assistance and advice to employees on a professional basis.

Q. The Aviation Department?

A. The Aviation Department was responsible for operating the company's aircraft and its fixed base facilities for aircraft.

Q. Now looking again at Exhibit 20, would you identify which of the functions of the Coordination and Services Department you have just described have been under your jurisdiction and for how long?

A. Well, the Treasury, Comptroller's, and Tax in the Coordination and Services group, and the land management activities in the Operations Management group, and these have been under my—among my responsibilities since I first became a director of the former Humble Oil

and Refining Company in 1965. The Land Management Department was added two or three years later.

Q. Now before describing the specific operating departments, would you give us a little background on the organizational setup of the operating management, the functional operating departments of the company?

A. The operations management of the company was responsible for directing the operating activities of the individual functional segments of the company. Each functional segment was organized into a separate department which operated independently of each other operating segment and was organized in a way so that it could perform pretty much on a stand-alone basis as a separate, single function company.

The operating departments were headed by either a vice-president, which was true in the major operating department, and headed by a general manager in the departments that were not in the operating department that were not quite as large.

Q. In terms of financial management, how were these operating department set up?

A. Each operating department is responsible for its own performance, both operationally and financially. It has been the philosophy of the company's management for a long-standing period that each department is evaluated separately and independently of each other department from a profitability standpoint and operational standpoint and overall performance.

Q. Is what you are referring to now what the company calls the policy of functional profitability independence?

A. Yes, that's correct.

Q. And is what you referred to a few minutes ago about each function having to stand alone as against other functions and as against competitors known as the functional stand-alone policy?

A. Yes.

Q. Would you describe how this policy is intended to have the individual functions put where they could compete with other functional departments or other independents in the industry in that particular activity?

A. Well, its been the view of our management, executive management, that by having each department independently responsible for its function performance is one of the most effective management tools that we can use in measuring the performance of the departments and to improving their operations. Under this plan each department is in competition with each other and which results, of course, in competition for the available funds for investment in the business activities of each of these operating functions.

Q. In effect are each of these functions also in competition with the other members of the industry operating in the same function?

A. Yes. There are companies with any industry which perform only one function or one segment of the petroleum business. Some perform more than one, but I will describe later which operating functions of the Humble Company were in competition with these other companies.

Q. Would you describe the exploration and production function?

A. The exploration and production function really is composed of three departments; exploration, production and natural gas. The Exploration Department is headed by a vice-president and he has responsibility for the profitable acquisition of reserves, of crude oil and gas. To do this, of course, means the providing the technical supervision of geological and geophysical activities that are involved in the activity of exploring for oil and gas reserves.

Also he has responsibility for land acquisitions, mineral fee acquisitions and providing the company with both short-term and long-term operating plans for the Exploration Department

Q. As distinguished from the Production Department, the Exploration Department doesn't do anything except locate the—

A. They carry on the exploratory effort needed to find potential oil and gas reserves and then they are responsible for drilling the wildcat exploratory wells to determine whether or not the reserves do in fact exist. And if that turns out to be the case, why then the properties are turned over to the Production Department for further development.

Q. Now describe the activity of the Production Department.

A. The Production Department again is headed by a vice-president. And this department was responsible for the profitable operation of all of the companies producing oil and gas propetries including the operation of the natural gas plants and the related facilities.

This involved, of course, maintaining a technical staff, providing engineering service, petroleum engineering advice and counsel, the development of drilling programs, the development of operational programs, and, again, was responsible for its proper performance in the producing of oil and gas.

Q. Now describe the Natural Gas Department.

A. The Natural Gas Department was headed by a general manager and it was responsible for the profitable purchase and sale and distribution of natural gas. This department is considered to be an operating department and it's grouped with Exploration and Production because of the close coordination that's required between their activities and those of the Production and Exploration De-

partment. But the Natural Gas Department is not a profit center. Its records of its transactions are combined with those of the Production Department because the physical facilities, of course, are common to both products, oil and gas.

Q. All three of these departments, that is, Exploration, Production and Natural Gas, are part of the exploration and production function for accounting purposes?

A. Yes.

Q. Now would you describe the Refining Department?

A. Well, the Refining Department was headed by a vice-president. This department is responsible for the profitable operation of the company's refineries and associated facilities which manufactured petroleum products, special products and petro chemical feed stocks.

Q. And describe a little more the functional organization of this department.

A. This department, of course, the headquarters of this department were located at the corporate headquarters. To assist it they have a Planning Department, rather, a planning group to assist in the planning of refining operations. They have an administrative group which was involved with the contractual and the affairs of the department, the employee relations activities of the department; and an operating group which is responsible for coordinating the activities of the existing refineries.

Q. Would you describe the Marketing Department?

A. The Marketing Department was headed by a vice-president. It is responsible, of course, for the profitable distribution and sale of petroleum products through the company's marketing facilities.

The vice-president has independent staff groups organized and provided to serve the Marketing Department.

These include such groups as, again, the planning activity, the staff group, administrative staff group to concern itself with employee relations matters and administrative matters. It has an advertising group which is responsible for developing the company's, or rather the marketing advertising plans and sales promotion programs. It has a distribution staff responsible for the engineering and planning of the physical facilities needed in the distribution system which involves, of course, the operation of terminals, tank trucks and other similar facilities.

And, finally, of course, there is an operating group which is responsible for coordinating the marketing activities of all the field organization.

Mr. Timken: Mr. Ragatz, Mr. Shapiro, do you think this is a good time to break; it is almost 4:30.

Mr. Ragatz: That's fine.

Mr. Timken: Very well. We will adjourn then until 9:30 tomorrow morning.

(Hearing adjourned, 4:25 p.m.)

STATE OF WISCONSIN
WISCONSIN TAX APPEALS COMMISSION

Docket No. I-3806

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),

Petitioner,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

CERTIFICATION

KAREN A. CHERRY
MINDLA COMINS
LORETTA PETERS,

hereby certify that as the duly appointed reporters, we took in shorthand the testimony and proceedings had in the foregoing matter on the 3rd day of October, 1974, and that the attached is a true and correct transcription of said shorthand notes and of the whole thereof.

Dated this 3rd day of October, 1974.

Karen A. Cherry
Karen A. Cherry
Mindla Comins
Mindla Comins
Loretta Peters
Loretta Peters

TRANSCRIPT OF PROCEEDINGS in the above-entitled matter held before the Wisconsin Tax Appeals Commission, in Room 229, City-County Building, Madison, Wisconsin, on the 4th day of October, 1974, commencing at 9:40 in the forenoon.

ORAL L. LUPER, recalled as a witness, having been previously sworn under oath testified as follows:

Mr. Morris: Let the record note that this is a continuing hearing and, Mr. Luper, you are still under oath to tell the truth to the best of your knowledge and ability.

Counsel, before we allow you to continue your examination, I have been informed this courtroom is available all next week. We will continue to use this courtroom until further notice.

The exhibits, if necessary, can be placed in a safe with the Clerk of Circuit Court which is in the Law Library, which is next to us here. If you so request and wish, they will be locked this evening. The exhibits in front of me will be placed in safes and returned back to this courtroom on Monday.

The hearing, if it is to continue beyond today, will be scheduled for commencing—no, I should say scheduled for hearing at 10:00 o'clock on Monday; and we will continue until this hearing is completed next week. If we need to go beyond the next week, we will then have to reserve a different courtroom, I think, and you will be given notice as to that.

Are there any special requests before we continue the examination, Mr. Ragatz?

Mr. Ragatz: Point of inquiry. Is the 10:00 o'clock starting time just for Monday?

Mr. Morris: Just for Monday.

Mr. Shapiro, do you have any special requests?

Mr. Shapiro: No, sir.

Mr. Morris: You may proceed in your examination, Mr. Ragatz.

Examination

By Mr. Ragatz:

Q. Mr. Luper, before we closed yesterday you had described the functional operations of what you described as the three major departments, exploration and production, refining and marketing.

Would you next describe the functional operation of the Marine Department?

A. Yes. The Marine Department was headed by a general manager. The Department was responsible for the profitable waterborne transportation of the company's petroleum products. The Department was also responsible, of course, for the safe and efficient operation of the waterborne eqquipment, ocean tankers and inland waterway equipment and, of course, operated the branch offices that were necessary for the operation of those vessels.

Q. And did this operation and Marine Department include the charter service?

A. Yes. If there was any additional transportation, water transportation required, this Department took care of both in chartering and the out chartering.

Q. Did you have any operations in this Marine Department conducted on the Great Lakes?

A. Not to my knowledge.

Q. And then there were not operations that tankers or other shipping came into ports in Wisconsin?

A. No.

Q. And how about the Mississippi River?

A. The Department did operate inland waterway vessels on the Mississippi River.

Q. Up as far as Wisconsin to the best of your knowledge?

A. I believe no further than Chicago.

Q. Are you aware of any other possible activity of this Department that would have relation whatsoever to the State of Wisconsin?

A. No, I do not.

Q. Was this Department operated as a special functional operation in the manner you have described for other departments?

A. Yes, it was.

Q. Would you next describe the coal and the shale oil department?

A. The coal and shale oil department was also headed by a general manager and he was responsible with his department for acquiring and operating—Well, excuse me.

He was responsible for exploring for and locating and acquiring deposits of coal and shale and for conducting all the operations incident to the mining and milling of that hydrocarbon deposit.

Q. And generally where did these operations occur?

A. They occurred in Illinois principally in some of the middle states and in the western states, Wyoming principally.

Q. And these are where these deposits are located?

A. That's where the deposits are located and the field activities of this department are conducted at the situs of those deposits.

Q. Are there any such operations in the State of Wisconsin?

A. No.

Q. Did this functional department have any other relationship whatsoever to the activities of Humble in the State of Wisconsin during the 1960's?

A. No.

Q. Would you describe the operation of the Minerals Department?

A. The Minerals Department was again headed by a general manager responsible for the exploration and discovery and acquisition of the non-hydrocarbon mineral deposits and was also responsible, of course, for the development of necessary mines and related facilities necessary to mine those deposits profitably. This department also operates as a separate independent operating function.

Q. Where were the operations of the department centered?

A. The field activities of this department were wide spread over the entire United States and Alaska.

Q. To the best of your knowledge were there any activities in the State of Wisconsin?

A. Not during the period 1960 to '68.

Q. Did this department have any other relationship to the marketing activities that were conducted in the State of Wisconsin to the best of your knowledge?

A. No.

Q. Now as to both of these latter two departments, were they doing anything to the minerals other than extracting them from the earth?

A. Well, during the period that we are discussing we had no coal mines in operation and we had no other mines in operation either.

Q. Would you describe the function of the Land Management Department?

A. The Land Management Department was headed by a general manager and his responsibility in his department was administering and disposing of the surplus properties that became surplus during the course of the company's operations.

Q. And what if any relationship did the activities of this department have with the State of Wisconsin?

A. There were probably a few surplus service station sites that this department was responsible for disposing of.

Q. And there will be another witness who can probably answer this question directly but, if you know, were the results of the sales of any Wisconsin properties allocated to situs for purposes of the Wisconsin separate accounting reporting?

A. It is my understanding that any profit or loss in the disposal of these Wisconsin properties was allocated to the activities of Wisconsin.

Q. Now you have covered the corporate organizational structure in summary form, but I would like you to discuss the characteristics and elements of the functional operating departments in a little more detail describing some of these key elements, if you would, please.

A. Well, as I have said before, the principal departments was the exploration and production, refining and marketing departments. Historically the basic organization structure of the company recognized these separate departments as independent, separate functions. This was demonstrated not only by the organization structure but it was also demonstrated by other policies and procedures and by the arrangement and configuration of the physical facilities involved in their operations.

Q. Is what you are mentioning here again related to what you described yesterday as the functional profitability independence policy of the company?

A. Yes. And just to illustrate some of the additional policies and procedures and the arrangements for physical facilities, just let me name a few.

First, each of the operating departments had its own separate management responsible for the proper conduct of that operation. Each of these management managers had a technical staff to provide all the supporting technical service that he needed to operate his particular operation. He also had the administrative staff when necessary to assist him. Each of these departments had its own sep-

arate and distinct field organization which conducted the operations in the field.

Q. Was there or was there not, as to each of these functional operating departments, a full management complement for each?

A. Yes, there was. That was the point I am trying to make. Each of the departments was responsible for the operation of the, or conducting the operations of this particular segment and operating the facilities that was involved in that operation.

Each department had a separate profit center which provided a means for recording the transactions involving expense and revenue so that a profit for that function could be determined.

Each department was recognized as an investment center. I mean by that that records were maintained for each of these departments to reflect the investments in properties and fixed plant and the operation of those properties so that the management of that department could be held to a stewardship of his operation of these particular properties. There was in existence a system of providing values for the transfer of raw materials and products interfunctionally between departments that is.

The purpose, of course, of having a system of a policy on transfer values for movements of products and raw materials between departments was to provide a basis for determining the functional proper loss of each of these major segments.

Q. Before you discuss that further, as background would you mention types of goals and operating programs that these functional departments have?

A. Well, each of the departments was responsible, of course, for preparing and developing its goals and objectives. Each was responsible for developing the programs required to reach these objectives. I might add here that

the attractiveness of an investment in refineries is directly related to the adequacy and secrecy of the source of raw materials and crude. The attractiveness of this refining investment is also directly related to the adequacy and assured outlet for the products, and this, of course, means that where assured and stable supplies of raw materials and assured outlets for products exist, the refining investments become attractive so that, therefore, a refinery is most interested in a quality and type of crude that is available to it and not so much in the ownership of the crude or the source from which it is produced.

By the same token, the Marketing Department is responsible—is interested in the type and quality products that are received from the Refining Department so this just means, I think, that when you have the exploration and production activities and the assured market outlets, there is less opportunity for disruption due to fluctuation and the demand and the supply balances.

Q. Now, did company policy require a mandatory flow through of the produced crude to the marketing outlets?

A. No, as I said earlier, because the Refining Department is primarily interested in the type and quality of the crude, and the Marketing Department is primarily interested in the type and quality of the products, there was no mandatory requirement for crude produced by the production Department to flow through the marketing outlets in the form of refined products.

Q. Did or did not the company have extensive dealings with third parties by its Production Department for buying and selling and by its Refining Department and by its Marketing Department acquiring the products it sold?

A. Yes, they did.

Q. What other outlets can you describe as these various functional departments? You mentioned transfer values. Would you first touch on the separateness of the accounting of these functions?

A. Each of these operating departments had its own separate accounting office so that the transactions for that department could be recorded and reported and the cost analyzed and the financial results of the operations reported.

Q. Now, with that background would you describe how that crude that was transferred from the E and P function to their refining function was valued and then how the product transferred from the refining function to the marketing function was valued for the purpose of interfunctional transfers?

A. That probably needs a little more description of our policy for transfer prices. It was our policy that the transfer of values for products and raw materials should be based upon a competitive wholesale market price.

For example, with respect to crude oil, the crude oil produced and transferred to the Refining Department was determined by the posted prices for crude oil, and, of course, this meant that the refining paid the same price for the Humble-produced crude which would be the posted price plus the relative tariff transportation that it would pay to any other producer for crude reserved at the refinery and in the case of products, products were transferred from the Refining Department to the Marketing Department again on the basis of wholesale market prices or some alternate value.

For example, the gasoline that was transferred was valued at the wholesale competitive market prices as published in Platt's. For some products, of course, there is no readily available quoted wholesale market value or price, and in these cases the representatives of our Marketing Department and our Refinery Department with both of their knowledge of the market, knowledge of the products, negotiate with each other on an arm's length basis in an adversary position to try to negotiate the ap-

propriate transfer value to the best of their ability, market orientated.

Q. Let me interject to ask as to the principal product lines where the greatest value was, was there or was there not a third party market that could be looked as to determine these interfunctional transfer values?

A. Well, in the first place, for the product lines that did have a quoted public market price or value—this was principally products of gasoline, distillates, heavy fuel oil. Now, in the period of time that we are talking about, 1965 to 1968, we were selling approximately a million one hundred thousand barrels of petroleum products a day and about somewhere in the neighborhood of 85 to 90 per cent of that volume was in the products which I enumerated which did have a market price. The remaining products were products some of which there were market activities for a similar product which provided knowledge of the market on which to base negotiated prices.

Q. Well, would you comment then on the valuation of these transfer between the functions as if they were single functions, separate companies—

A. That was the—really the objective of the system was to provide a basis of valuing transfers which would approximate the same results as if one separate independent company had negotiated with another separate independent company.

Q. Do you want to comment on the capital budgeting of the various functions?

A. This is another characteristic of the operating departments. Each of these departments prepared its own capital budget and its program for investments in their activity. They also, for each of these departments, provided their separate financial forecast which was needed to forecast their forward operations and the profitability of their forward operations.

There are other elements that I might comment on in addition to the ones that I have mentioned, that each department was responsible for the administration of all the employees assigned to that department which involved the employment, the training development, termination and the handling of employee benefits for these employees, and another element was that each of these departments had contracts with separate labor unions and each of these department conducted its own bargaining with these unions, so that when all these elements are taken together the entire organization of each of these separate functional segments is designed to permit them to operate independently and separate from each other segment.

Q. And each were set up on a self-sufficient basis?

A. As I have described, they were on a self-sufficient basis, except as I had discussed yesterday, the availability of some of the Coordination and Service Departments which was provided at the corporate level. These departments were free to consult with those staff departments, if they felt it was necessary.

Q. I want to go back to one point on the interfunctional transfer prices. If you compared the precision with which you are able to measure the interfunctional transfer price between E and P and refining, would the precision with which you are able to measure the transfer price between refining and marketing—which would you say is easiest to measure and most precise in its measurement?

A. Well, since we have posted prices for the raw materials, moving from production to refining, and since there are some few products in the moving from refining to marketing which we have to negotiate prices, I suppose you would say that the measurement of revenues to the Production Department is a little more precise than the measurement of the revenues to the Refining Department from its transfer of products to the Marketing Department,

but I believe that in either case the system that we have and we have employed it consistently throughout the years, is entirely adequate for the accounting purpose for State regulatory matters, tax matters.

Q. And these accounting procedures are utilized in reporting for State tax purposes and other purposes consistently?

A. Yes.

Q. Would you describe some of the miscellaneous activities that each operating function performed and whether they were performed separately and independently of other operating functions?

A. There were a number of other miscellaneous activities which each of these functional departments conducted separately. First, each department was responsible for the inventories of materials and products under its jurisdiction, and responsible for inventory control measures, the proper stocking of materials, and providing adequate internal controls and records of the inventories on hand.

Second, each of the departments was responsible separately for maintaining the warehouses needed to provide storage for materials and products. Each of these departments were responsible for their own design of the warehouses, the operation of the warehouses, the decision of providing materials, handling equipment, and the maintenance of that equipment, and each department maintained its own accounts receivable records and its own billing records. Each department maintained its own accounts payable records, and as such, of course, was responsible for conducting its own relationships beweeen that department and its specific suppliers and customers.

Q. Who set the credit and collection policies for each functional department?

A. The credit and collection policies are really established by each operating manager. They utilize the services of the credit staffs in the Treasurer's Department.

Q. How was insurance handled by each of the departments?

A. In order to minimize the cost of insurance, the company had a policy of self-insuring for risk less than 10 million dollars. However, there are cases where insurance is needed below that level because of governmental requirements, contractual requirements, or other requirements, and in these cases the operating managements of each of the companies requested and arranged to obtain the insurance that was needed for their particular operation.

Q. Describe how product advertising and sales promotion programs are carried out.

A. Well, I think I stated yesterday that the responsibility for advertising and the development of sales promotion programs for the marketing of the company's petroleum products was the responsibility of our Marketing Department.

Q. As to any particular region or area, and specifically as to any state, can you give us maybe an example of how this might be implemented?

A. Yes, each region office in the field organization of the Marketing Department on its staff there was a regional advertising manager, and he was responsible for implementing the advertising program and developing the sales promotion programs that were appropriate for his particular geographic area.

Q. Now the respondent has presented and we have agreed to the admission of Exhibit 19 which has four parts, and which are photocopies of pages of the *Milwaukee Journal,* one coming from each of the four years in issue, 1965 through 1968, and I would like you to look at these four newspaper pages and describe to the best of your knowledge how these ads may have come about and who was responsible for them, who implemented the program?

A. I have examined these photocopies. Would you please restate your question?

(Question read)

A. First, it is important to recognize, I think, that each of these four ads is what our marketing people refer to as a traffic builder. A traffic builder, of course, is designed to promote the sale of products in the local area in which the promotion or the ad is run. It is clear also from these ads that each of these four ads were a part of the Marketing Department's advertising and sales promotion effort.

Now as to how they were actually designed and used in this particular case, it would be—it would have been the function of the advertising manager at the Central Region Office in Chicago to design these ads and to arrange for their preparation and placement in the newspaper. It is also noticed here that one of these ads is an ad for the promotion involving tickets to the Green Bay Packers football game. This indicates, of course, that this was an ad designed specifically for the Wisconsin market and it was the—the ad itself was conceived and requested and arranged by the district manager of Humble in Milwaukee, and he arranged with the advertising manager in Chicago to get this particular ad developed.

Mr. Morris: On the record.

By Mr. Ragatz:

Q. Mr. Luper, I believe your last response related to the ad which is exhibit 19-C relating to the Green Bay Packers. Would you further indicate or point out what indications there are in this ad that was directed to the Milwaukee area?

A. Well, right in the headline refers to the Milwaukee area. It says "Enter the Enco Packer Sweepstakes in the Milwaukee area". Second, there is indication here that the signs were provided at the participating dealers in this promotion to indicate that that service station, that deal-

er, was participating and the tickets for this sweepstakes could be obtained at that station. And this little notice here says "Win the Green Bay Packers", again an indication that it was intended for the Milwaukee and Wisconsin area.

Q. Would the Milwaukee district manager have initiated that particular ad?

A. I think I said that it is my understanding he did initiate this ad.

Q. Would you describe the other two ads, 19-B and 19-D that relate to or that use premiums?

A. Well, these two ads, one ad uses a spice set as the sales promotion merchandise and the other ad uses a glassware as a promotion merchandise.

Now it would have been normal procedure for these two ads to have the design by the staff of the regional advertising manager in Chicago and he would have provided for the preparation of the ads and their insertion. However, in promotions of this kind there are usually a number of promotions available and the district manager in this case, the district manager in Milwaukee, undoubtedly reviewed all of the sales promotions available to him and selected these two particular promotions as ones that he thought would be attractive and appropriate in his marketing area.

Q. Can you compare the process of the district manager requesting an ad and then selecting the ad with the procedure that might be followed had he gone to an independent advertising agency?

A. Well, the advertising staff of the marketing department causes to be created in each year a number of sales promotions. And then these become available for implementation in the field organization, and the material is made available to the regional advertising manager.

He, of course, sees to it that the district managers know what is available and the district manager then has the opportunity to decide what he thinks would be attractive and appropriate for his marketing area. And then he requests the central region advertising manager to have these ads prepared and inserted. When that's been done and agreed upon with the central region advertising manager, then he would arrange for the reproduction through our outside advertising agencies.

Q. So much of his service would be like that of an outside agency?

A. Oh yes, it is.

Q. And the cost of running of the ad would be—

A. It would be a part of the advertising expense of the central region and the regional office.

Q. Charged to Wisconsin?

A. Charged to the central region in Chicago.

Q. But then allocated to Wisconsin?

A. No, no.

Q. Well, another witness will discuss the mechanics of that, but in the overall accounting of that kind of an expense it is allocated back to Wisconsin, isn't it?

A. It is my understanding that this expense is charged to the expense of the region office. If I am mistaken, another witness can correct me on that.

Q. Now these ads use the name "Enco" but that name wasn't in use all over the country by Humble, was it?

A. No, it was not.

Q. Before when we were talking about the activities of the functions, I think I neglected to ask you whether, in summarizing, you could say that these functional departments were in competition with each other as to capital requirements as well as prices and profits?

A. Yes. Since our corporate management evaluated each of these functional segments on the basis of their profitability, that placed them in competition with each of the other operating segments. And this was, of course, an

important factor in their competing for the available fund for investments and the projects within their functional segment.

(Exhibit 21 marked for identification)

Q. I show you what has been marked Exhibit 21 and ask you to identify what that is.

A. This exhibit is entitled "Humble Oil and Refining Company, Oil and Gas Operations and Refinery Locations, 1960 to 1968". It reflects the geographical activities for oil and gas and refinery operations.

Q. Was this exhibit prepared at your direction?

A. Yes, it was.

Mr. Ragatz: I would like to move the admission of Exhibit 21.

Mr. Shapiro: No objection.

Mr. Morris: Exhibit 21 is received.

By Mr. Ragatz:

Q. Would you describe the geographical aspect of Humble's operations?

A. Perhaps I should begin with the crude production activities of the production department.

On this Exhibit 21 the areas or the states where crude was produced by Humble is indicated by the areas colored in gray. In addition, the states in which Humble produced gas is indicated by the cross-hatching. The locations of refineries are located by the symbols on the maps with the names of the locations in which they existed.

Q. How was the exploration department geographically organized?

A. The character of Humble-wide operations, of course, required each of the operating segments of the company to have to conduct its own field activities and each of the departments had its own field of organization, the geographical areas covered by each department.

Q. Now, just generally I am wondering if the Exploration Department had decentralized offices?

A. Yes, they do. They have six division offices which operate on a decentralized basis.

Q. I assume these are geographically related to the areas of exploration activities?

A. Yes, these activities, the field activities are located at the areas where the deposits have either been found or are prospective.

Q. How about the production department?

A. The production department also has six division offices located in the principal producing areas. These offices are also operated on a decentralized basis to the extent that it is economically feasible and practical to do so.

Q. Describe the Marketing Department's geographical organization.

A. The marketing department's field activities, of course, were concentrated in the areas, in the market areas where they have the most concentrated population and in the industrial areas, and their field organization consists of seven region offices, and, of course, each of these region offices had a number of district offices which reported administratively to it.

I should have said also that the production department also maintains district offices which reported to the division office.

Q. And how is the refining department geographically organized?

A. The refining department, its field activities, of course, are conducted at the location of the refineries, and at each refinery there is the management's technical and administrative staff that is required for profitable and safe and efficient operation of that refinery.

Q. And the Marine Department?

A. The Marine Department has its field activities conducted from six branch offices located at the principal ports of call.

Q. Now, where were the marketing efforts concentrated during the years here in issue?

A. Where were the marketing efforts concentrated?

Q. Yes.

A. They were concentrated in most of the states of the United States, but concentrated, I would say, primarily on the eastern seaboard and the gulf coast area.

Q. Do you have other than the marketing office in the State of Wisconsin?

A. Yes, we have a district office in Milwaukee. Is that your question?

Q. That district office is the one that directs the operations of the Wisconsin marketing department?

A. The district office in Milwaukee directs the marketing activities in Wisconsin.

Q. And there are no other offices in Wisconsin?

A. No.

Q. Now, you mentioned the concentration of marketing was in the eastern areas. Would you explain the difference between a mature marketing area and an expansion area?

A. That is a term which we use to indicate the extent of development of a marketing operation. We think of the mature areas as being areas where we have been in business for a large number of years and have become well established and the brand name is largely recognized and we obtained an acceptable position in the marketplace.

The expansion areas is the term that we use for areas where we are making a new entry into a new market. It is an area where it is a new effort. We are not widely known. We have limited facilities and it requires additional investment over long periods of time to achieve the market position that would be acceptable as a mature market.

Q. Which of these categories does the Wisconsin marketing area fall into?

A. It would be an expansion area market.

Q. Now, organizational—wise where does the Wisconsin marketing district fit it?

A. The district office in Milwaukee reported administratively to that marketing region, central region office for Chicago, and in turn that region office was administratively responsible to the headquarters marketing department or the marketing department in Houston.

Q. Did this Wisconsin district marketing office have any reporting responsibilities to other functions such as the refining department or the exploration and production department?

A. No.

Q. How would you characterize the results of your operations in Wisconsin during the 1960's?

A. The results of the operations in the 1960's were very unsatisfactory from a point of view of profitability in relation to the sizeable investment we had in Wisconsin. As a matter of fact, on an accumulated basis we had only a loss in these years in Wisconsin and that required us, of course, to consider what alternatives we had for future operations in Wisconsin.

In 1970 it became necessary for Humble to consider disinvestment in Wisconsin. However, before we could develop and implement a viable disposable plan, the Federal Energy Administration instituted product allocation controls and, of course, this prevented us from changing the nature of our operation in Wisconsin.

However, since there was no necessity for us to continue the Wisconsin operation, we chose not to change the brand name from Enco to Exxon when we adopted that new brand name back in the beginning of 1973.

Q. I think the Commission might be interested in expanding on the name change a little bit, describing the rationale company-wide for changing the name, considering the problems and the cost involved.

A. Well, I think that our problem with the brand name probably was well publicized over the years at the time the Standard Oil Company of New Jersey merged several domestic companies of the United States into the Humble Oil and Refining Company, we had several brand names; a brand name for each of six or seven companies, and, of course, from an operating point of view with customers traveling around the country that was very unsatisfactory so it became evident that we needed to reduce the number of brand names we had. So at that time we adopted a new brand name, Enco, and we continued from that point on using the Esso brand in all the locations where we had normally used it, and that was primarily on the eastern sea board, north eastern, and we used Enco in the remaining markets in the United States, but as time went on there was a considerable confusion in the minds of our shareholders and in our customers. We had the name of Standard Oil Company of New Jersey, which was the parent company, and the customers and shareholders were confusing that name with other petroleum companies which had the name of Standard in them. That was a problem to us. There was not any great understanding among our customers of the relationship between Standard Oil of New Jersey and Humble Oil and Refining Company so out of this grew a desire of the company to try to simplify it by giving a corporate name and a brand name which were identical.

We were confronted, however, with what that new single brand name might be. Obviously we had a great investment in the name of Esso and we would have liked to use that nationwide, but judicial proceedings determined that we were not going to be able to do that so this meant that we would never be able to use Esso nationwide so for that reason we decided we would go to a single brand name.

The name of Exxon was created and the parent company, Standard Oil of New Jersey, changed its name to the Exxon Corporation, and when Humble Oil and Refining Company—when that company was merged into the new Exxon Corporation, its name was changed, as I said yesterday, to the Exxon Company, USA.

And so we did change our brand name then almost every place in the United States to Exxon except in a few states where we had an expansion effort and the future was clouded just as to what the activity would be so we decided we would not change the brand name in the states, just as in Wisconsin, until that decision could be made.

Q. I take it that there was some expense involved in the areas where you did change the name?

A. Yes, there was some expense.

Q. You characterize the results of your Wisconsin operations during the 1960's as unsatisfactory. To what do you attribute these results?

A. Well, the marketing department did not achieve the results they expected primarily because they did not obtain the volume growth that was anticipated, and then this with the attendant high unit cost and the cost of entering into a new area and in an area at a time when prices were weak, the anticipated profits just did not materialize.

Q. When you say "prices were weak" did the circumstances which are commonly known as a price war have any impact on that situation?

A. That is a common expression for a market which has weak prices, yes.

Q. When you go into an expansion area and you go into an expansion program, what does that do to the overhead of the operations during the time that you are expanding volume?

A. Well, of course, when it is decided to go into a new market area, it takes a complete market staff. It is a

very difficult marketing assignment so it takes a complete staff, and the cost associated, the overhead cost associated with that staff has to be absorbed by that particular geographical area, and it comes at a time before the volumes had grown to what is desired; so, therefore, it results in a very high unit cost.

Q. When you go into an expansion area what kind of time period do you usually allow to implement the program and see that through to its success?

A. Well, it is a long, long period. It first takes a considerable period to decide to make such an entry into a new market. Once that decision is made, a considerable investment is required to get an initial foothold in the market and then continued investment and good operations is needed for a number of years before you could expect to come to the objective that you might have success in the beginning. It's commonly recognized that even a service station with a developed or mature market takes as much as three years after it's built for it to reach a degree of capacity that you expect for it to have.

Q. During the 60's while you were in this expansion program was there any necessity from a company-wide standpoint that you had to continue to maintain the Wisconsin marketing operation?

A. No, there was not.

Q. Does that apply during the period 1965 to 1968?

A. Yes, it did.

Q. In other words, you were not dependent upon that sales outlet for disposing the product?

A. Neither the company nor the marketing department was dependent on that Wisconsin operation. As a matter of fact, I believe that during the net period of time, the volume of petroleum products sold in Wisconsin was something less than one percent of Humble's total product sales.

Q. I refer you again to Exhibit 21 and ask you to point out whether or not there were any exploration or production or any refining activities conducted in the State of Wisconsin?

A. In the period indicated there were no operations of the Exploration and Production Departments and the Refining Department in the State of Wisconsin.

(Exhibit 22 marked for identification.)

Q. I show you what has been marked Exhibit 22 and ask you to identify what that represents?

A. Exhibit 22 is entitled "COMPANIES ENGAGED IN ONE OR MORE COMPETITIVE OPERATIONS OF THE PETROLEUM INDUSTRY."

Q. Was this document prepared under your direction?

A. Yes, it was.

Q. And what was the purpose of its preparation?

A. The purpose was to indicate a representative list of companies which engage in one or more of the segments of the petroleum business.

Q. As examples?

A. Well, as an example, the first section of this exhibit is entitled "Companies with Exploration and Production, Refining and Marketing Operations." These are companies that engage in most of the principal segments of the industry.

Q. Your company would fall into this category, I take it?

A. Yes, it would.

Q. What is the second category?

A. The second category is a listing of companies with primarily exploration and production operations.

Q. Just to contrast these two categories, the second category of "companies" would be just engaged in what we have today in this proceeding referred to as your E and P function?

A. Yes, that's correct.

Q. Do you want to give for the record indications of companies involved in the Category I, that is all three of the major functions?

A. Yes, the representative list of companies listed in Category I is, as shown here, Murphy Oil Corporation, Skelly Oil Company, Standard Oil Company of Indiana, Texaco, Incorporated, Union Oil Company of California, and I guess I could have listed many others such as Gulf or Continental Oil or other similar companies.

Mr. Morris: Mr. Ragatz, Exhibit 22, does this pertain to the State of Wisconsin only or other states?

Mr. Ragatz: This is the industry itself.

Mr. Morris: Total industry?

Mr. Ragatz: Total industry in the United States.

By Mr. Ragatz:

Q. Mr. Luper, just as background, how many independent competing companies are there in the industry in the United States?

A. It has been estimated there are more than 40,000 independent competing companies in the petroleum industry in the United States.

Q. That would include companies with all of the basic functions as well as companies having one or more of the basic functions, I take it?

A. Yes.

Q. Would you describe and indicate for the record examples of companies primarily engaged in the exploration and production function?

A. Yes. The companies listed here on this exhibit under Category II are the Aztec Oil and Gas Company, General American Oil Company of Texas, General Crude Oil Company, Louisiana Land and Exploration Company, Superior Oil Company, and of course there are many others, for example, like Placid Oil in Dallas.

Q. Describe the third category shown on that exhibit.

A. The third category of companies shown on Exhibit 22 are companies with primarily refining operations. Included in this group are the Edgington Oil Company, Rock Island Refining Corporation, Sunland Refining Company, Texas City Refining, and the U. S. Oil and Refining Company.

Q. And describe Category IV, if you would.

A. Category IV is entitled "Companies with Primarily Refining and Marketing Operations," and listed in this category are representative companies such as Beacon Oil Company, Caribou Four Corners Oil Company, Little American Refining Company, Powerine Oil Company, and United Refining Company.

Q. And Category V?

A. In Category V is a representative list of companies with primarily marketing operations, and this list includes the East Coast Oil Corporation, Hudson Oil Company, Inc., Martin Oil Service Company, Inc., Sigmor Corporation, and Star Service and Petroleum Company.

Q. Where did you compile this set of examples from? What kind of information did you use?

A. The source of the names—the companies listed on Exhibit 22 were taken from the Dun & Bradstreet Million Dollar Directory 1974. Each company is classified on the basis of its standard industrial classification number prescribed by the United States Office of Management and Budget.

Q. I take it that these are just samples, and, for instance, as to the E and P function, that there would be thousands of other possible examples that could have been added to Category II on this list?

A. At least thousands, yes.

Q. Would the same be true of marketers?

A. Yes, it would be.

Q. Could you describe now and relate to your policy of functional profitability how the various categories of companies shown on this exhibit compete with your various functions?

A. Yes. The individual and separate operating functions that I have described for Humble were in competition with the kinds of the companies that I have indicated on this Exhibit 22.

Q. For example, your exploration and production function is competing with the companies in Category II?

A. Yes, that is correct.

Q. And your marketing function would be competing with companies in Category V?

A. Yes.

Mr. Ragatz: I would like to move the admission of Exhibit 22.

Mr. Shapiro: No objection.

Mr. Morris: Exhibit 22 is received.

By Mr. Ragatz:

Q. Mr. Luper, now that you have described the overall structure and organization of the company, would you give the reasons for why you have the separate operating departments organized under one corporate entity?

A. There are a number of reasons, I think, why there is—why the individual separate operating functions are combined under one single corporate entity.

Some of the reasons for this—first, the petroleum—in any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.

So, in the case of the petroleum industry it is—where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore when there are—when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time.

Q. How does the combination of these separate functional departments under one corporate entity affect the profits stability of the company?

A. Here again the placing individual segments under one corporate entity does provide greater profits stability for the reason that the factors which nonparallel and nonmutual economic factors which may affect one department may be offset by the factors existing in another department. And this produces a greater opportunity for profits stability.

Q. Is this what the economists sometimes refer to as a risk offset?

A. Yes.

Q. In terms of risk, perhaps you could explain the nature of the relative risks involved in the different functional operations.

A. Well, here again the combination of the individual segments under one corporate entity does reduce the impact of risk. The operations of the exploration and production department have a very high degree of risk, and much higher than other types of industrial activity. So when this type of operation is combined under an entity with other operations with less risk, it provides a diversification and gives some protection against the risk hazard.

Q. Do any other reasons come to mind for the use of a single corporate entity combining the separate operating functions?

A. Yes, yes. Again, but putting the individual segments under one corporate entity provides an opportunity to provide a corporate staff, corporate staff services such as I described earlier in my testimony that enables the entities to attrack high quality of staff employees. The cost and economics are obtained because the more efficient and effective use of these staff groups when they are made available on a corporate-wide basis.

Q. You have now described the organizational structure of the entire company and given certain explanations as to various aspects of it including some of the company's policies of management, policies of organization. Were these policies and this basic organization in effect during the years that are in issue in this audit?

A. Yes. During the years at issue the fundamental management philosophy of the company and its basic organization which involved the independent operating functions, there was no change in these during the period that we have been discussing.

Q. And would that include the period 1960 through 1964 as well as 1965 through 1968?

A. Yes.

Mr. Ragatz: I have no further question.

Mr. Morris: At this time we will take a five-minute break.

(Recess taken at 11:18 a.m.)

Mr. Morris: On the record.

Mr. Shapiro: Shall I proceed?

Cross-Examination

By Mr. Shapiro:

Q. Mr. Luper, your office is located in Houston, is it not?

A. Yes, it is.

Q. And in what building; is it the Headquarters building of Humble where your office is located?

A. You are speaking of the time during 1960 to '65—68?

Q. We are relating basically to the years in issue, yes.

A. Yes. That was the headquarters for the Humble Oil and Refining Company.

Q. Can you describe generally how large that building is?

A. Well, that building is 44 stories high and at that time the company was occupying perhaps two-thirds of the space.

Q. Was the company occupying other buildings in Houston in addition to that?

A. We had a research center there at that time.

Q. And how large a building generally was that?

A. I really don't know the size of the building. It was a four-story building I believe.

Q. And was that research center directed primarily at a given function of your company?

A. It was engaged entirely in the research for exploration and production activities.

Q. And how many employees were located in the 44-story building that you described?

A. At that time? I really don't know the answer.

Q. Can you give an approximation?

A. Let's say between 2500 and 3000.

Q. There is, no doubt, a detailed organization chart showing the activities of the personnel located in that building, is there not?

A. I am sure there are.

Mr. Shapiro: If it please the Commission, I would like to request that such a chart be produced for the record pursuant to the full disclosure requirement.

Mr. Morris: Is the chart available?

Mr. Ragatz: This is the first time anybody ever asked for one. No, there is not one here.

Mr. Morris: Is there a possibility to produce a chart during the pendency of this action?

Mr. Ragatz: Well, certainly not today.

Mr. Morris: I would suggest that counsel take this up during the noon hour and see if one is possible. I will take motion under advisement at this time and make a ruling at a later time.

You may proceed, Mr. Shapiro.

Mr. Ragatz: I might just say for the record on that subject that what I understood him to have asked for was a chart of the people in that building; and I seriously doubt that there are such charts in existence. But we could find out.

Mr. Morris: The reason I reserved a ruling is for after we come back from lunch, if it is impossible you can't produce it, put it on the record then. But I would suggest that you explore that possibility during the lunch period and I will reserve a ruling.

Mr. Shapiro: I would like to submit, Mr. Commissioner, that such information will be helpful in this Commission's determination of the fundamental issue in this case.

Mr. Morris: I will take the question up at 1:30.

Mr. Shapiro: Yes.

By Mr. Shapiro:

Q. Mr. Luper, are you a participant in a stock-option plan?

A. Yes, I am.

Q. So that in addition to your salary, benefits may accrue to you as a result of the overall profitability of the company by virtue of this stock option plan, isn't that true?

A. I don't know about the profitability. If the price of the stock increases, I would benefit by it.

Q. And are you a participant in a bonus plan?

A. Yes, I am.

Q. Then is the bonus associated with the profitability of the company?

A. The maximum amount of the bonuses that may be paid is associated with the profitability of the company. I don't believe the maximum has ever been reached.

Q. But there is that relationship. Humble's gasoline is marketed, and again we are relating to the years in issue, through approximately 29,000 service station outlets in the United States, isn't that correct?

A. That is in the proper range.

Q. The operations extend into some 47 states, isn't that correct?

A. I am not positive whether it was 47—

Q. In that range though.

A. —or not, but somewhere between 43 and 47 perhaps.

Q. Isn't it true that about one-half or just under one-half of these service stations are owned by the company and leased to dealers?

A. Again, I don't know the exact percentage, but there are a large number of stations owned and leased to independent dealers.

Q. And with respect to the other service stations, approximately one-half or 15,000, what type of arrangement do you operate these through which the gasoline is sold?

A. Are you speaking about those stations which the company does not own?

Q. Yes, sir.

A. Those stations are operated by independent merchants as a separate business.

Q. And of this entire group of stations that I referred to, about 3,600 are operated by the company through company employees, isn't that correct?

A. They were—Again, I can't verify the number that you specify. But there were a number of stations that were operated by managers. We did not consider them employees.

Q. Did you have companies operated by employees?

A. Do we have stations?

Q. I am sorry—stations operated by employees?

A. We had a few stations, relatively few stations operated by company employees.

Q. And the others are operated by dealers?

A. Yes.

Q. Of those 29,000 or in that category of stations, do you know how many are supplied directly by the company?

A. You are carrying me into the detailed marketing operation which I am really not qualified to tell you.

Q. I thought I recall from your testimony that at one point in your career you were manager of the marketing—

A. Of a region.

Q. —of a region. But then it's safe to say, is it not, that a very substantial number of these stations were supplied directly by the company?

A. Yes.

Q. And the others were supplied by jobbers and other resellers?

A. Yes.

Q. Is it true, Mr. Luper, that the company sales are classified as between the motorist consumer, industrial and government by some 85 per cent granted outlets and 10 per cent at wholesale and 5 per cent to the government?

A. I just don't know the answer to that question.

Q. Does it seem to be a reasonable percentage breakdown?

A. I would not want to express an opinion.

Q. And is it true that in your company marketing operations there are some 12,000 service station employees, bulk plant and terminal employees, drivers and so forth?

A. Again I cannot verify that figure, that number.

Mr. Shapiro: I would request that the reporter take note that under the full disclosure requirement, the respondent will request that that information be supplied for the record.

Mr. Ragatz: I would like to be heard on that.

I am sure that counsel for respondent can ask a thousand questions that no one person in an executive capacity in a company of this size could answer in full disclosure and that every time he thinks of a question that the witness doesn't happen to know the answer to, we will be here for months, and we are going to be sending things back and forth to Houston for months to look for it.

This is the senior vice-president of the company. He is here to testify to the best of his knowledge, and my position is that this is all that full disclosure requires.

Mr. Shapiro: The issue in this case is a very fundamental one and it touches upon all the operations of the company. We submit that the information that is required is extremely important to the Commission so that it can make an intelligent evaluation and determination of the issue.

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: Mr. Chairman, I would like to point out further that the testimony has already indicated that representatives of the respondent collectively spent a couple of months in Houston for the purpose of asking this client questions, and if the respondent doesn't have the answers to these kinds of questions now and hasn't asked me or someone else from Humble in advance to trial, I don't think you can fault Humble people or fault us for not having the information at this time.

There was no request by respondent for discovery. There was no request to me to provide an organizational chart of some nature, I don't think, so how we can hold up these proceedings and make these kinds of requests at this time—after all, the respondent had the initial opportunity to audit and did audit extensively. People spent weeks down in Houston. I don't see how we can now use the full disclosure statute to hold up the proceedings on this case because there are certain questions that counsel can think of that we don't readily have the answer for.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: This was a hearing under oath and before the Tax Appeals Commission, and 71.10 (3) of our statute requires full disclosure by the taxpayer under oath at the hearing before the Tax Appeals Commission.

Mr. Morris: Mr. Shapiro, I think in this case, this is a basic case set forth in the new concept. If you had as much time down in Houston and you had as much time for discovery as Mr. Ragatz, why wasn't this discovered prior to this hearing?

Mr. Shapiro: The auditors may not be prepared to make an extensive examination that is required in a hearing in Houston.

Mr. Morris: The question of the charts and/or development of the company as requested by yourself at this time are the kind of questions that are basic or primary to this case. Why weren't they asked during the period where discovery was available to you or during periods when you were auditing in Houston.

Mr. Shapiro: Again I refer you to the express terms of the full disclosure statutes.

Mr. Morris: Again I will get into argument with counsel about this later. We have a witness here who I would like to hear testify and I will get into argument along these lines later.

Regarding the testimony, I will say this for the Commission, the Commission here is sitting for one purpose; that is to have all the evidence available at its disclosure or at its hearings. We would like this to happen, but again I have to agree with Mr. Ragatz in a way. I am not going to delay this hearing for weeks waiting for both sides to go back and forth and try to discover things.

Mr. Shapiro: We are not asking for weeks of delay.

Mr. Morris: I will take this up at 1:30 with counsel on both sides.

Again, this witness is here to testify to the best of his knowledge and ability, and at this time I would have to say he is.

As to the material and information he does not have, I will take this up with counsel at 1:30. You may continue.

By Mr. Shapiro:

Q. Mr. Luper, is it not true that about 77 per cent of the gasoline marketed by your company comes from Humble refineries?

A. I just cannot verify that question.

Q. And of the remainder what percentage would come from exchanges?

A. I do not know.

Q. You have testified that the Enco brand is used and has been used. In how many states was the Enco brand used?

A. I believe in the states in which we have marketing operations, but the Enco brand was used in all these states except in the range of 13 to 15 states, something of that order.

Q. I would like to refer back to my previous question for a moment. The gasoline marketed by your company comes primarily from two sources, doesn't it, from Humble refineries and from exchanges?

A. Yes, I think that is true.

Q. And a very small percentage, less than 1 per cent, comes from purchases, isn't that true?

A. I couldn't verify the latter statement. I do not know.

Q. In marketing Humble gasoline is importance placed on such factors as hours of operation of the service station, appearance, availability of credit, confidence in the product quality, quality of services, and price?

A. Mr. Counsel, naturally I have a general knowledge of these matters, but here again you are asking questions directly involved in the marketing policies and procedures of the Marketing Department which I am not very closely associated with.

Mr. Shapiro: May I ask Counsel whether one of his witnesses will be more closely associated with marketing-type activities of the company?

Mr. Ragatz: I think the answer is no.

Mr. Shapiro: Can we proceed?

Mr. Morris: You may proceed.

The Witness: If you would like for me to give you a general response to your question, I will be glad to do so.
By Mr. Shapiro:

Q. In marketing Humble gasoline, is importance placed on factors relating to the retail outlets such as hours of operation, appearance, availability of credit, confidence in product quality, quality of service and price?

A. All of these things that you mentioned are of interest to our customers and consumers, and I am sure that they are considered an important element in our marketing operations.

Q. Certain characteristics of gasoline effect the performance of an automobile, isn't that true?

A. Again I am not qualified from an engineering point of view to comment on that, but, of course, it is well known or well said to be true.

Q. For example, starting and warm-up and vapor lock are controlled by the hydrocarbon composition of the gasoline?

A. I am not qualified to answer that question.

Q. In 1967 did your company develop a carburetor detergent additive to reduce maintenance and operating costs?

A. I do not know.

Q. Are you familiar with the additives developed by your company?

A. Only from the mere fact that we do have additives. I am not familiar with the additives.

Q. And these additives have some effect in eliminating emission pollution, do they not?

A. Again I cannot answer that from direct knowledge.

Q. Are you familiar with the additive HPA?

A. I have heard the additive name, yes.

Q. Was that developed during the period in issue?

A. I really don't recall.

Q. But it might have been?

A. It might have been.

Q. Are additives that are developed by Humble made available to other oil companies?

A. I do not know.

Q. Are the additives patented?

A. I assume that they are.

Q. Are these formulas known only to your company?

A. I do not know.

Q. Is that your impression that they would be?

A. I have no impression about it on that point.

Q. Is a significant part of research and development devoted to improving the quality of gasoline?

A. Yes.

Q. How much money is spent annually on such research and development by Humble?

A. I haven't done enough preparation in this line to be able to tell you.

Q. Isn't it true that an automobile gets better mileage with a heavier gasoline?

A. I do not know.

Mr. Shapiro: I ask, Counsel, do you have a witness that is more familiar with the quality of the product?

Mr. Ragatz: We have a couple of witnesses that have engineering backgrounds, but I am not aware of what their knowledge is on the type of questions you are asking. You will have to just wait and ask the question.

By Mr. Shapiro:

Q. Mr. Luper, the lending process in your refineries is accomplished with the aid of computers, is it not?

A. I understand that to be the case.

Q. And the refinery is an extremely complex and highly automative process, is it not?

A. Yes, it is.

Q. Could you explain what is meant by "blending"?

A. Not from a technical point of view, I could not.

Q. But from another point of view, a layman's point of view?

A. I really would not want to attempt that one. I don't know enough about that to express an informed opinion about it.

Q. Are seasonal variations taken into account, that is a different gasoline is manufactured for winter than that manufactured for summer, isn't that true?

A. I understand that that is true.

Q. And are finer variations accounted for, for example, when the company is marketing gasoline in Illinois or

Wisconsin where seasonal changes in temperature occur fairly rapidly, does the time lag in delivery from a refinery to a service station cause problems at times?

A. Counsel, you are getting into an area which I am not just that intimately familiar with. I can't answer that question.

Q. Is it true that there must be a great deal of planning to compensate for these changes in temperature?

A. I am sure there is a great deal of planing involved in the proper distribution of the petroleum products.

Q. And what geographic areas that differ with altitudes, humidity and so forth, they require a different blend of gasoline—for example, San Francisco and Reno, Nevada—

A. Well, I don't know that from direct knowledge. I understand that the differences in altitude can make a difference.

Q. Would the gasoline manufactured for a 1950 model automobile work satisfactorily in a 1968 model?

A. I really couldn't tell you.

Q. Do you know whether octane ratings increased during this period?

A. During—

Q. During the period in issue?

A. I think it is—to answer you specifically—I do not have that information. It is again my impression that during this period of time the octane rating within the industry did have a tendency to increase due primarily to the changes in the automobile engines.

Q. And this resulted from a variety of complex and costly refining processes, did it not?

A. I am certain that changes were required, but again I cannot give you the specific information about it.

Q. Is the gasoline produced by one of Humble's refineries the same chemical mixture as that made by another company before the additive is put in?

A. I am not qualified—I am not a chemical engineer and I cannot answer that question.

Q. Your operations include the purchase of land and construction of service stations, isn't that correct?

A. Yes, it is.

Q. Is this accomplished by a particular segment of the company?

A. Yes, it is.

Q. Is this accomplished by a particular segment of the company?

A. Yes, it is.

Q. And what segment is that?

A. What segment is it?

Q. Yes, sir.

A. The segment that purchases land for service stations is the marketing function, the Marketing Department, and it is done by their field organization in the field location, the regional offices.

Q. And what officer or employee in the company has the top responsibility for that type of activity?

A. Well, the overall responsibility rests, of course, with the vice-president in charge of marketing, the head of the Marketing Department, but of course he delegates that authority to make purchases in accordance with the Department's budget to various individuals in the field locations.

Q. And the vice-president in charge of marketing is headquartered at Houston?

A. Yes, in the Marketing Department at Houston.

Q. Now these stations that are constructed are made to sell your brand of gasoline, are they not?

A. Yes.

Q. Is the income that is received by the company in the form of rent, does that income alone constitute a reasonable rate of return on the investment?

A. I have just not made a study of that. That again is in the area of the financial analysis of the Marketing Department.

Q. I understood you were one of the top financial managers of the company?

A. I was the manager in the central region, yes. The rents, it was—it was our policy to try to establish rents which represented a reasonable return on the investment.

Q. But in addition to that station, I think you pointed this out in your previous testimony, it would benefit your company by providing an outlet for the product, isn't that correct?

A. Yes.

Q. So that when you look at the rental received and the degree of assurance of an outlet, these two factors make a reasonable return as a combination, do they not?

A. Well, we do not consider on a combined basis.

Q. But there are the two factors involved?

A. One factor is the rent associated with the real estate investment and another factor is the margin associated with the sale of petroleum products.

Q. Is the assurance of a retail outlet important to the company in terms of being able to construct the kind of refinery and distribution system that you need?

A. Would you please repeat that?

(Question read)

A. Well, I would say that the construction of the refinery—the thing that is considered there is the type and quality of the crude that is going to be available to that refinery. With respect to the service station, as I have said

before, the existence of a stable and assured market outlet is directly related to the refinery investment.

Q. During the period in issue, the refinery that is indicated on Exhibit 21, the map, as Benicia, California, was that during this period in the process of being constructed?

A. It was in the process of being constructed in part of these years, yes.

Q. Now wasn't a principal motivation for the establishment and construction of that refinery the market for automotive products in California—in California plus neighboring, some four neighboring states?

A. Well, a motivation was to have a product, a source of product supply for all of the sales requirements that we might have in those areas.

Q. Isn't it true that during that period the number of vehicles was growing very rapidly, seven to ten per cent a year in the California area?

A. I can't verify the percentage, but California was a rapidly-growing gasoline market.

Mr. Morris: Gentlemen, we will stop there.

(Noon recess, 12:00-1:30 p.m.)

AFTERNOON SESSION

1:45 p.m.

Mr. Morris: Let the record note that a conference was held with this Commission, with counsel for the petitioner and respondent regarding the motions made and the objections thereto at this morning's session. The motions that were made by Mr. Shapiro, and objections made by Mr. Ragatz are further taken under advisement and again will be brought before this Commission on Monday afternoon at 1:30. At that time those motions will be further explored and ruled upon if necessary.

Mr. Ragatz: Mr. Chairman?

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: For the record, and just to be sure that I am clear on what we talked about and what was agreed, I have stated this morning our position as to the timeliness of the request made by Mr. Shapiro. And I would like the record clear that we feel he and the Department had every opportunity to make these requests months ago or even during the course of their audit when they were supposed to be making those inquiries; and that we think it's unreasonable to first make these inquiries at the time of trial.

Nevertheless, to the extent that it will not slow down the process of this case and not materially inconvenience our client, we are going to try to produce a couple of documents for them. And let me state for the record what I understand to be the limit of his request.

I understand that he wants, if one exists, an organizational chart covering the headquarters building down in Houston for the period, or at least some part of the period in issue; and, secondly, he wants one or more exchange agreements covering product that came into the State of Wisconsin during the years in issue.

Mr. Shapiro: That's correct.

Mr. Morris: All right. And any further requests than that?

Mr. Shapiro: No, sir.

Mr. Ragatz: One other thing that I might add, that is the timing of your taking up this motion again might require further extention in that it's doubtful that we are going to be able to get ahold of anybody over the weekend down in Houston to look these things up. So it probably will be the first of the week before the search can be made and probably impossible to get any documents up here by Monday afternoon.

Mr. Morris: I will amend my ruling to Wednesday. I assume we will be here till Wednesday. That's an assumption I have to make.

Mr. Ragatz: I assume so too

Mr. Morris: Wednesday at 1:30 on October 9th.

Mr. Shapiro: I have one modification. In the event the witness cannot supply it readily, we would request earnings on investment as between E and P, refining and marketing, the three major departments. We request that earnings on investment be supplied.

Mr. Ragatz: That I am going to object to very strenuously. That sounds like a terrific amount of work and this is a very late date to be making that kind of a request and in this complicated proceeding.

I don't know that that information is kept in the form that it's requested and I don't think that the Department of Revenue ought to impose upon our client to put that kind of information together at this time. Had that request been submitted a month ago or six months ago, I would have deemed it more reasonable. But I deem it unreasonable at this time and I therefore object to any requirement that we produce that kind of information at this time.

Mr. Shapiro: Could we submit that that type of statistical information would be readily available.

Mr. Ragatz: And I submit that that should have been asked for then at the time of audit or certainly it could have been asked for in some kind of discovery proceeding, or I could have been asked to attempt to obtain it weeks or months ago. It is too late for that now.

Mr. Morris: Gentlemen, if the arguments continue we will be here for a long period of time. And I have had a request to try to move the witnesses along and try to get through the testimony.

I would only request you to explore them, Mr. Ragatz, to see if it is available and to report back to Mr. Shapiro.

On the motions made and the objections made I will take the motions under advisement. I will allow counsel from both sides to make arguments at the time of the ruling on motions and that will be at 1:30, October 9th.

Anything else to come before me before we proceed? Hearing none, you may continue with your examination, Mr. Shapiro.

Mr. Shapiro: Thank you.

By Mr. Shapiro:

Q. Mr. Luper, in order to assure high quality standards and to protect the brand name or brand names, trademark and good will of the company, it is necessary to have the new complex manufacturing systems that are illustrated by the Benicia, California plant, isn't that true?

A. The refineries in the industry all make a very good product; and I believe that the recognition given to the quality of the product, it is clear that good quality products can come from any type of refinery or most refineries.

Q. Do the additives used by Humble require special equipment and methods for mixing into the gasoline?

A. I just do not know that.

Q. Is the additive a rather thick substance that would tend to settle at the bottom of a storage tank if it were just merely dumped in?

A. I do not know.

Q. And at what point in the distribution system is the additive mixed into the gasoline?

A. I would be speculating on that. I know, of course, that additives are introduced at the refinery. Whether they are introduced at any other location in the distribution system I am just not aware of that.

Q. Do you know whether the additive is packaged, is placed in a certain type of container?

A. No, I do not.

Q. But it is manufactured by Humble, is it not?

A. Humble does manufacture some additives.

Q. And do they acquire some additives from other parties?

A. I am under the impression that we do, but, again, I am not directly involved in that.

Q. Does gasoline that is received under exchange agreements include additives?

A. I presume that they do.

Q. The gasoline that is received from an exchange partner is refined according to Humble's specifications, is it not?

A. Again, that's not in my area of operation but I understand that to be the case.

Q. Isn't it true that Humble adds its unique additive to practically all of the gasoline received on exchange?

A. Again I just really can't tell you for sure about that.

Q. Are there basically two types of exchange agreements?

A. I don't know really what you are referring to and it is my understanding that a subsequent witness will be able to respond more directly to the questions in this particular area.

Q. Do you know whether such agreements are set forth in signed documents?

A. Are set forth in what?

Q. Signed documents.

A. Yes, I believe they are.

Q. And do these documents require compliance with certain specifications?

A. I have never really seen or read one of these exchange agreements, so I can't tell you of any direct knowledge.

Q. Do you know how many or which companies you have exchange agreements with during the years in issue with respect to crude oil?

A. No, I don't. But a subsequent witness will have some information on this point.

Q. Do you know what official of Humble would negotiate a major exchange agreement covering a large quantity of crude oil with another supplier?

A. It would be the general manager of our Supply Department or one of his assistants, delegated assistants.

Q. And that official is in Houston?

A. Yes.

Q. Do you know what official would negotiate a major exchange agreement of finished product with another supplier?

A. Again, that would be the general manager of our Supply Department.

Q. The same place?

A. I believe that that is true.

Q. An exchange of products, whether it be crude oil or gasoline results in an economic advantage to both exchange partners, does it not?

A. I assume that like any other contract mutually arrived at, that each party expects to receive the benefit from the agreements.

Q. Does it accomplish price utility or in other words a savings on transportation costs?

A. Yes, I think it could.

Q. The net result is the same as having your own product at the location where you want it, isn't that correct?

Mr. Ragatz: I will have to object. I think that calls for a legal conclusion that this witness is not qualified to respond to.

Mr. Shapiro: That is not a legal conclusion.

Mr. Ragatz: What constitutes your own product title? What are you talking about?

(Last question read)

Mr. Morris: Do you understand the question?

The Witness: Yes.

Mr. Morris: Can you answer the question?

The Witness: I have my belief about it, yes.

Mr. Morris: Well, I will allow him to answer the question based on his knowledge.

Mr. Shapiro: I submit it is a business judgment.

Mr. Morris: Yes, on his business judgment.

Mr. Shapiro: Yes, sir.

Mr. Morris: You may answer if you understand the question to the best of your knowledge and ability.

The Witness: I regard an exchange agreement as a purchase and sale and an independent transaction so I would not place one in such a position with the other. I would not say they are the same.

By Mr. Shapiro:

Q. It does accomplish the result of having the product where you want it, does it not?

A. Yes, that is why the agreement was made.

Q. How much initial investment was required by your retail dealers?

A. Well, I couldn't give you an exact answer on that because obviously it depends on the location, the size of the station, the place where it is, the amount of facilities involved, how much inventory is being carried.

Q. Well, do you assist the dealer in financing such an investment? I should say does Humble assist the dealer in financing such an investment?

A. On occasions we do.

Q. In what manner?

A. Well, again you are carrying me into activities that I have to remember for several years, but on some occasions we can supply the equipment, loaning equipment, and in other cases we can give him credit for the purchase of products and even going further, there are times when we can even make direct loans to him.

Q. Through what office is that accomplished?

A. Well, that is accomplished—initiated in the district office and it's the process of, you know, in the ordinary case that may be all we require, but in other cases it might require the review with the Central Region Office.

Q. Does it in any case require review or approval or assistance from the Houston headquarters?

A. Normally I would say that if it is in the general policy that we sit down, no; but obviously if the situation were peculiar or if it was an extra large amount of credit involved and the dealer had limited financial resources, whether they were an unusual risk, why it might have to—the matter might be referred to the Marketing Department at the headquarters in Houston.

Q. Does the company have standard lease forms?

A. I believe they do, yes.

Q. And were these drafted originally or are they drafted or revised at Houston?

A. You are talking about, of course, the lease form for service stations?

Q. Yes, sir.

A. I really have no direct knowledge on that, but I presume like any contract, it is reviewed from time to time to keep it a modern document.

Q. Would the Legal Section at Houston be responsible for that work?

A. Not necessarily. The Regional Office has legal counsel, too, and it could be done there, but it also could be done in Houston.

Q. Standard forms, I take it, are designed in Houston, are they not?

A. I would say that most of them are.

Q. Is dealer training an important activity of Humble?

A. Yes, I would say it's an important activity of the Marketing Department of Humble.

Q. Do you know how many training centers there are in the United States?

A. No, I do not.

Q. Are there any in Wisconsin?

A. I do not know.

Q. Do you know where any of them are located?

A. You mean during the period in which we are talking about?

Q. Yes.

A. I am certain that there are training stations in each of the regions such as Houston, for example, and I am more familiar with Texas as I reside there, and in Abilene; maybe Fort Worth, Dallas.

Q. With reference to Wisconsin, would that be Chicago, Milwaukee or Memphis?

A. Well, the Regional Office for the Wisconsin area has been Chicago and Memphis. I am certain within that regional area—I am certain there were training stations, but where they are located, I just don't happen to know.

Q. Are all new dealers required to take the training course?

A. I do not know that. I doubt it.

Q. But some dealers from Wisconsin may go to the regional training center in order to get the benefit of that course, isn't that corect?

A. I presume that's true.

Q. Does Humble have a uniform credit card system?

A. Humble has a uniform credit card.

Q. This credit card would allow the driver to purchase gas in Wisconsin and outside Wisconsin at Enco as well as Esso brand stations, would it not?

A. Yes, it would.

Q. Isn't this an important marketing tool and valuable to the local dealers in the State of Wisconsin?

A. I would say that it was a valuable marketing tool and it is also a value to the dealers.

Q. Now, this credit card is used in all of the states in which Humble does business, isn't that true?

A. Yes. I have to qualify that in one respect. I haven't actually checked this, but I assume that the credit cards in the Wisconsin area would carry—it might carry an Enco brand name as opposed to Exxon. I am not really positive. I haven't thought to check up on that.

Q. From which office is the credit card system administered?

A. Well, the credit card system overall, of course, is—if you are talking about the system—it is the general policy—

Q. Yes, sir.

A. —to carry out the credit card arrangements. These would be made by the Marketing Department in Houston, however, in implementing the system it requires, of course, some accounting and collection effort, and there are—I have forgotten how many locations in the period we are talking about, but there were two or three accounting centers, credit card centers in that period.

Q. What official in Houston is responsible for general administration?

A. The vice-president of marketing.

Q. To what extent does Humble design service stations for continuity of appearance for the driver that goes from state to state?

A. Well, here again certain design features are developed through the engineering staff in Houston in the Marketing Department of Houston, but you must remember that across this country there is a wide variety of terrain and a wide variety of shapes and sizes of locations and a wide variety of zoning laws, and so that means that in addition to some overall criteria that might be established by the headquarters Marketing Department, the region offices have to have a certain latitude to permit them to use these in a way to conform to local laws and conditions and zoning permits.

Q. Do you know approximately how many people at Houston would be involved in this activity?

A. I really don't have any data to tell me what this would be.

Q. There is a considerable time lag or time lapse between the manufacturer and the use of gasoline, isn't that correct?

A. That's too broad a question and covers so many different locations I wouldn't know how to answer that really.

Q. If I can elaborate a little more, from the refinery to the terminal or bulk plant, it might be one to 20 days?

A. Again I don't know, but I think that might be possible.

Q. And an additional two to 12 days in storage?

A. Again without knowing, that sounds reasonable.

Q. And another two to four days to the filling station?

A. Two or four days for moving it from the terminal to the filling station?

Q. Yes, sir.

A. I think that normally that would be done the same day.

Q. And the product may be in the filling station up to eight or ten days, might it not, in some instances?

A. I would think so.

Q. Now this time lag between the refinery and the consumer seems to hold about 30 days or more in some cases. Does this mean that the refiner must manufacture the gasoline sometime ahead of its use—that is obvious, I think.

A. Yes, I would say that is true.

Mr. Ragatz: I will stipulate to that.

Q. If the weather is unusually warm or unusually cold, this may create problems in meeting consumer expectations of good driving, might it not?

A. Expectations for good driving?

Q. For good driving.

A. I don't really understand.

Q. Well, there might be problems with respect to the climatic or the extreme changes in temperature?

A. If you mean that the extreme—are you talking about gasoline?

Q. Yes, sir.

A. I will just have to answer your question, I really don't know.

Q. Might there be another problem to overcome as a result of this time lag, and that is to prevent the gasoline from adversely changing the characteristics during this period?

A. Again, I am not technically qualified to answer that.

Q. Well, I have a number of more questions along that line, but apparently you don't feel qualified to answer them.

A. I am not involved at all in refinery operations, and I have no background on product quality or its processes.

Q. Well, is it true that the refining and marketing functions are faced with a large number of variables as well as changing economic conditions?

A. Yes, I think you could say that.

Q. During the years in issue Humble experienced periods of long and short supply, isn't that true?

A. I haven't made enough analysis of that to really say.

Q. On the basis of retail sales estimates, can Humble plan reduction requirements and move production long distances, provide terminal storage, and provide local delivery with a fairly high degree of accuracy?

A. Obviously the company must make operating programs for its production and distribution activities, and these must be based, of course, on estimates of sales demand and weather and other things, but I don't know how you would define a high degree of accuracy, but obviously it is—it is subject to variation, but I believe we do it well enough to make the immediate service to our customers.

Q. Gasoline distribution includes the network of retail outlets and also the tankers, barges, pipelines, trucks and terminals that are required to move a product from refinery to the retailer, isn't that true?

A. All of those facilities in one form or another are used in the distribution system.

Q. Doesn't the operation of this network as well as the refineries to manufacture the gasoline, require a delicate balance of supply and demand in order to be efficient?

A. Well, obviously to the extent that accurate forecasting can be made, the accuracy has a direct bearing upon the efficiency which could be expected to—

Q. What services are rendered by the Houston office to further that objective?

A. To further the objective of an efficient distribution arrangement?

Q. Yes.

A. Well, the overall plan for the distribution of products, of course, does—it is developed in Houston and primarily in our Supply Department as to what the requirements will be, and then those requirements are made known, of course, to the transportation facilities, and other people involved at terminals, and those people then each in their own sphere of activity have to implement that action.

Q. What services are rendered by the Houston office to keep the various departments current on information?

A. Would you please tell me what you mean when you say "various departments"?

Q. Are there such things as daily or weekly letters or bulletins that are distributed by Houston?

A. You mean within the Marketing Department?

Q. Marketing and/or the Refining, yes.

A. There are no weekly or no bulletins of that kind, to my knowledge.

Q. Now with respect to the newspaper ads that Mr. Ragatz offer on direct, does the "Tiger in the Tank" slogan offer an effective promotional device nation-wide for Enco and Esso?

A. Yes, I believe we felt that the "Tiger in the Tank" slogan was a very effective sales promotion.

Q. This is a distinctive trademark for all of Humble's gasoline which indicates a powerful gasoline, isn't that true?

A. It never impressed me as being powerful, to denote the idea of a powerful gasoline.

Q. Do you know where the mats were prepared for the ads, other than that relating to the Green Bay Packers, where the mats were prepared?

A. I am not very familiar with the processes by which one goes from an idea to the finished product, but on the Packer ad I presume that the idea was conceived by the district manager in Milwaukee and that he transmitted that idea to the Central Advertising Department and Advertising Manager in the region office and that manager, with the help of the advertising agency, probably had either designed or had the mats prepared.

Q. Where was the "Tiger" slogan conceived?

A. I really don't know. This goes back before my time, I believe. I understand that the "Tiger" was used within some of the company affiliates before it became—before it was resurrected and became popular in the 1960's, and so I really don't know the answer to that question.

Q. There is an advertising function carried out at Houston, is there not?

A. As I said before, the advertising staff in Houston is a part of the Marketing Department.

Q. Does Humble promote products by uniform packaging?

A. Yes.

Q. And brand names?

A. Yes.

Q. Lubes and canned oils and greases, are they branded?

A. Yes.

Q. What brand names?

A. We use, again, the brand name Exxon and we use the brand name Uniflow. We may have others.

Q. But during this period was it probably Uniflow?

A. During this period, of course, we did not use Exxon. We used Uniflow. We used Enco and we used Esso. Those three I am sure we used.

Q. And those products were sold throughout the United States?

A. Well, the Enco products were sold in the area where we had the Enco brand; and the Esso brand had products sold in the area where we used the Esso brand.

Q. Is promotional display equipment—let me rephrase that.

Where would promotional display equipment be designed and manufactured?

A. I believe that the equipment would be designed primarily by the Engineering Department, engineering staff of the headquarters marketing. That would not rule out, of course, the engineering staff at the region levels to also have constructed equipment for the display of signs to meet their particular situations. And then you asked about the construction. They would be, of course, constructed by outside contractors.

Q. Who has authority to set and adjust prices for tires, batteries and accessories?

A. The vice-president of marketing has that authority and he also has the authority to delegate that authority to other managers in his organization.

Q. And who has that authority with respect to gasoline?

A. Again, the vice-president of marketing has that authority and he may delegate that authority to others in the Marketing Department.

Q. Who has the authority to prescribe uniform selling forms or contracts?

A. I will have to assume when you say "uniform" that you mean uniform for the entire marketing operation.

Q. Yes, sir.

A. And in those situations very likely the marketing staff and marketing legal counsel in Houston would draft that type of a uniform agreement. But that, of course, wouldn't rule out the marketing staff and the marketing legal counsel at the regional level to design a uniform agreement for the area of its operations.

Q. Who has authority to prescribe guarantees or warranties on products?

A. Again that would be under the responsibility of the vice-president of marketing.

Q. Who has authority to prescribe the sales territories?

A. You mean by that the establishment of districts?

Q. Yes, sir.

A. That would be the vice-president of marketing.

Q. And is he also vested with the authority to establish new stations?

A. Oh, yes. That doesn't mean that he is not the only one, of course.

Q. Well, under certain circumstances final approval for more extensive setup of new stations would be with him, would it not?

A. Well, the capital budget for each year would be supported by a program, a building program of service stations. And when the Marketing Department had approved that program, why then, undoubtedly, the region marketing managers then would have authority to proceed to build those stations.

Q. Who has the final authority to approve those budgets?

A. I would say that the final authority, if you are talking about the annual budget, that was approved by the Board of Directors of Humble.

Q. I take it the Board of Directors would have final authority if a large expansion of service station outlets in a given area were contemplated?

A. If that expansion were in a new area or was of a sufficient magnitude, it would have been reviewed with the Board of Directors.

Q. And that also would be true with respect to a contraction or withdrawal from an area, would it not?

A. Again, it would depend upon the size of the area of the withdrawal and the magnitude of the investment that was involved.

Q. Is there a dollar limitation on the magnitude of investment?

A. Yes, there is, but I do not know what that limit was at that particular time.

Q. Who has final authority to enter into long-termed exchange agreements for either crude or finished product with other companies?

A. I think I stated before it was the general manager of our Supply Department and his delegated assistants.

Q. And who has final authority to enter into contracts for the purchase of tires, batteries and accessories?

A. The responsibility for deciding what is needed would be the Vice-President of Marketing. But the contract itself might be executed by our Purchasing Department.

Q. Are Atlas tires sold in all Humble Service stations?

A. No. If you mean Humble stations defining the Humble brand, the answer would be no.

Q. Enco?

A. Yes, sir.

Q. Is the Purchasing Department within the supply function on Exhibit 20, sir?

A. Exhibits 20.

Mr. Morris: At this time we will take a ten-minute break.

(Recess taken at 2:30 p.m.)

Mr. Morris: Mr. Shapiro, you may proceed.

Mr. Shapiro: Thank you.

Examination

By Mr. Shapiro:

Q. The final authority for the purchase of tires, batteries and accessories is with the Purchasing Department I believe you have testified, is that true, sir?

A. No, I did not testify that. I testified that the vice president of Marketing had the responsibility for the purchasing of tires, tubes and batteries, but he requested our purchasing office to execute the contract in the purchase for the marketing function, and, of course, the marketing function is allocated an appropriate part of this purchasing office expense to charge against the marketing function.

Q. And if there is a contract executed, it is executed by the Supply Department?

A. By the purchasing office.

Q. And the purchasing office is in the Supply Department?

A. It is a segment of the Supply Department.

Q. And as we noted in reference to Exhibit 20, that is the Supply Department; that is approximately in the middle of the page?

A. Yes, that's correct, one of the corporate staff services.

Q. Are there contracts in existence covering Humble's needs over extended periods of time with respect to tires, batteries and accessories?

A. I do not know what period this provided for in the existing contracts.

Q. Who is authorized to borrow money for working capital and long-term loans?

A. The treasurer has that authority, and, of course, if the amounts were sufficiently large and if it involved the undertaking by the corporation, it would have to be approved by the Board of Directors.

Q. Who decides how to invest surplus funds?

A. The treasurer of the company.

Q. Where are the principal banking functions performed?

A. We have important banking facilities in most of the large cities where we have offices. It would include Houston, Chicago, Philadelphia, New York and so forth.

Q. Who would be responsible for coordinating and setting up major policies with respect to banking?

A. The policies for the company, of course, were developed by the treasurer of the company.

Q. Do you know where the flow of cash from Wisconsin sales were deposited?

A. I do not know specifically where the funds were deposited and the channels it went through, but normally the receipts would be deposited in local banks for transfer to other banks.

Q. Transfer to other banks?

A. Yes.

Q. Probably outside Wisconsin?

A. It could be.

Q. In most instances would it be the banks outside Wisconsin?

A. Yes, I would say it was.

Q. What was the source of the money used for investment in Wisconsin property?

A. Would you restate that question?

Q. What is the source of the money used for investment in Wisconsin property?

A. Well, if you are speaking about the actual funds, of course, they are provided from the corporate treasury.

Q. And what money was used for the payment of wages for Wisconsin employees?

A. Well, all the money that the corporation had was the corporation's money, and the corporation bank account was required by law so in that respect it was the corporation's money.

Q. Do you know whether borrowed funds were used to finance investments in Wisconsin?

A. I really don't know the answer to that question because the initial investment in Wisconsin was made by our parent company and not by Humble.

Q. But there are instances where funds are transferred from out of the state into Wisconsin, isn't that true?

A. Well, it could be. I am not aware that it was or was not.

Q. Do you know for what purposes that would be?

A. You mean for funds transferred in?

Q. Yes, sir.

Mr. Ragatz: I believe the witness has testified here that he doesn't know. I don't know how you can put another question to him when the witness says he doesn't know whether the funds came in or not.

Mr. Morris: Do you have an understanding of the question?

The Witness: Yes, I can elaborate on that. I would suspect that any funds that came in were for local use for, you know, small purchases, petty cash. If there were any, I would say it would be for that purpose.

Q. Are standardized accounting forms designed and used by Humble?

A. The answer to that is yes, but, of course, each operating function also has designed standard forms for their section.

Q. Are there accounting manuals in existence?

A. There is—there was an accounting manual and an accounting manual for each of the operation segments.

Q. And where are these accounting manuals prepared?

A. They are prepared—with respect to the corporation manual, they would be prepared under the supervision of the comptroller of the company. As far as the accounting manuals for the separate operating functions, these manuals would probably be prepared under the supervision of the comptroller for that particular operating function. Each of the operating functions has a comptroller on the staff.

Q. What accounting reports go to Houston with respect to operations, inventories and so forth?

A. Well, let me just confine my response to the Marketing Department, if I may first. The accounting activities in the Marketing Department were performed primarily at the regional level. Each region had an accounting

office, and, therefore, as transactions occurred, the source documents flowed into these regional accounting offices for recording and handling. On a monthly basis the retail offices provided the comptroller of that marketing function in Houston reports so he could make a consolidated report, financial report and operating report for the marketing function, and then, of course, the marketing comptroller forwarded a comparable report, but more summarized and an abbreviated form to the comptroller of the corporation so he might prepare a consolidated report for the corporation as a whole.

Q. And can you explain that procedure with respect to the other functions?

A. Yes, it was substantially the same except that the accounting centers were also identical. In the Production and Exploration Department the procedure was substantially the same as I described for the Marketing Department. For the Refining Department accounting offices were maintained at each of the principal refineries and here again they prepared the reports necessary for their local use and provided summaries periodically to that refining comptroller in Houston in the same way I described.

Q. Is there a uniformed system of accounts established for that major department?

A. Yes.

Q. And who has the responsibility for the establishment of that?

A. Well, as far as the accounts for the corporation as a whole, of course, the comptroller, the corporation comptroller is responsible for that, but as that moves down into the operating functions, the functional comptroller can use an accounts system that is compatible with what is required by the corporation comptroller.

Q. What is the principal area on which the company draws its research and development data?

A. Each of the operating functions have staff technical employees who are familiar with and are engaged in the research activities, but the actual research itself is performed outside the Humble Oil and Refining Company. This morning we were talking about office space and I inadvertently told you that the office space research—I left the impression that it was Humble property. It is actually owned by the Esso Products Research Company which is a separate company, a wholly-owned subsidiary at that time of Humble, and it provides research activity for the exploration and production functions and this service is available on a world-wide basis. Each affiliate purchases research from this company and similarly in the area of research the manufacturing processes and product quality, that was purchased from another wholly-owned subsidiary research company.

Q. That's the E and P and Refining Department—do the E and P and Refining Department of Humble carry on research and development activity?

A. Not in any large measure, but you must understand that they must do enough to be familiar with what is going on, what is required in the way of new operations so that they can coordinate their needs with the research organization and also, of course, what results from research that are obtained is needed to be transmitted on down to operating personnel within the company.

Q. The research and development activities that you have described conducted by Humble is related to new product development and other development, is that true?

A. No, I wouldn't say that the work that is carried on by Humble employees would be involved directly in the development of new products. That has to be done by the research organization.

Q. Is it related to the improvement of products?

A. No, I think I meant to explain that it is in the area of being knowledgeable about what research is needed and the stages of its development and the results that are coming out of it to be able to have some evaluation for it.

Q. Who exercises either the approval or disapproval regarding the top executives of the Production, Refining and Marketing Departments with respect to appointments, promotions, salary increases, bonuses, and the establishment of retirement policies?

A. Well, there are a lot of parts to that question.

Q. Yes, there are.

A. And that cannot be answered yes or no.

Q. Can you break it up?

A. Break it up? Let's start with the promotions, the promotions and assignments, and here again the manager or the vice-president, well, you referred to the exploration and production—

Q. Yes.

A. The Vice-President of Exploration and Production would have authority to make assignments and promotions of employees up to a certain executive level. Above that executive level it would be approved by a Board committee.

Q. That is the Board of Directors?

A. A committee of the Board of Directors, yes.

Q. And with respect to salary increases—

A. Salary increases, again for the level from the wage earners up through a certain executive level, would be approved by the Vice-President, and recommendations for increases, salary increases for these higher executives would be reviewed by the Board committee and of course this was to maintain a certain coordination and compatibility among the higher executives of the company.

Q. And how about the bonuses and retirement policies?

A. The overall retirement policy was developed by the employee relations manager with consultation with the operating functions, and presented and reviewed and approved or disapproved by the Board of Directors.

Q. Do you have Exhibit 20 nearby?

A. What was that?

Q. Do you have Exhibit 20 near you, sir? I take it you are referring to employee relations also in the middle of the page?

A. Corporate staff department, yes. Again, that is a service that is performed for all of the departments so that there is a certain uniformity of employee policy among all of the employees.

Q. Is there established on a company-wide basis a wage incentive plan?

A. No, there is no wage incentive plan on a company-wide basis. The Marketing Department, I believe, has an incentive wage plan for a few of its retail heat operations; in other words, where we have a retail operation of heating oil, it is customary in the industry for this particular group of people to work on an incentive plan.

Q. Is there established on a company-wide basis a bonus plan?

A. No. In that period of time with Humble Oil and Refining Company, there was not a bonus plan. I do not believe there was a bonus plan at that time.

Q. How about a profit sharing plan?

A. No, there was no profit sharing plan.

Q. Paid vacations?

A. Yes, paid vacations.

Q. Retirement plan?

A. Yes.

Q. Employees' welfare program?

A. Do you mean by that such as a sickness and benefit policy—

Q. Health and accident program, yes, sir.

A. Health and accident, yes.

Q. With respect to labor relations is that function carried on at all in—I am looking again at Exhibit 20.

A. All right.

Q. —in the Employee Relations Department?

A. No. I testified this morning that each operating function had its separate contracts with its separate labor unions and the management of each operating function conducted its separate bargaining activities with the unions in their particular department.

Q. Is the corporate staff involved in any labor negotiation matters at all?

A. Yes. There is a small, one or two people in the Employee Relations Department, that provides consultation. And I believe in the Law Department we have a lawyer that's expert in labor law and he is also free to—he is not free because the operating function gets charged with the allocated part of his expenses. But nevertheless he is available to give them service in this area.

Q. Are all state income and franchise tax returns prepared in Houston during this period?

A. We will have another witness who can answer that question for you specifically. I believe they are.

Q. I believe you testified that each of the three major departments prepares its own budget and that final approval for that rests with the corporate staff or lawyer?

A. The budget each year was approved by the Board of Directors.

Q. Are forecasts and statistics on operations prepared by headquarters?

A. I think we might stop to make a distinction by headquarters.

Q. I am referring to Houston, yes, sir.

A. Well, we need to make a distinction at Houston because, keep in mind, please, that the corporate activities are all handled under this corporate management group. But in this operations management group that you see at the bottom of Page 20 that I described, although they are in Houston, they are a part of that particular operating function.

So, to get back to your question, if I might take marketing as an example, at each level beginning with the region level the accounting manager at the region level prepares and provides the necessary reports for the use of the management at the region level. A similar function is prepared in Houston by the Marketing comptroller for the use of the Marketing Vice-President and his staff. And then in more condensed and abbreviated and summarized form, the comptroller, the corporate comptroller, provides reports for the Board of Directors.

Q. Mr. Luper, crude oil has a value, does it not, only because it may be converted into other products?

A. Well, it does have a value because it can be, among other things, converted into other products.

Q. Now the first major steps for converting crude oil is the refining stage, is it not?

A. Again, this is a complex matter and I couldn't give you the answer that might be technically correct. But I would say that I presume that the refinery is the first major step.

Q. And the last major step would be the network of retail outlets as a means of disposing of the product, would it not?

Mr. Ragatz: I am going to insert myself here just to ask for a clarification. It seemed to me that the question asked related to the conversion of raw material into p od-uct; and all of a sudden he is talking about distribution of finished product and he has got me confused. I am sure he

has got the witness confused. And I don't object to the line of questioning, but I think he ought to ask a specific question that follows.

Mr. Shapiro: We have an intermediate stage of refining which changed the raw or crude product into another product. That was my understanding of your answer.

The Witness: Well, my answer merely meant to say that the crude is refined, that is the manufacturing operation, and it does end in the production of petroleum products. I wouldn't really call that an intermediate stage. That's the end result of the product.

By Mr. Shapiro:

Q. The gasoline that results from the refining process is then disposed of by means of the network of the retail outlets, is it not?

A. Not entirely. The products manufactured at the refinery are available for sale by the marketing function and a portion of those products are distributed and eventually sold through service station outlets. But there is also a very large portion of the products that are sold through other distribution channels to industrial and other types of consumer a counts.

Q. But isn't the major portion of, say, over 80 per cent in your estimation sold through retail outlets?

A. No. I would not say that. I do not have the data at hand to prove or disprove it, but I consider the volume of distillates, the volume of heavy fuel and the volume of gasoline that goes to industrial accounts, consumer accounts, I feel quite certain it wouldn't be anything like 80 per cent.

Q. Mr. Luper, if a faulty battery is purchased in Wisconsin at an Enco station and it breaks—I should say it was purchased in Wisconsin and it breaks down in California, that battery would be replaced in that state under warranty, would it not?

A. I have never had a battery break down in Wisconsin that I had to replace in California, so I don't really know that I can answer directly. I have had some difficulty. But I would say that I believe what you say is true.

Q. Was it in the 1960's that Humble moved from some quarters in Houston to the 40-story building that you referred to?

A. Yes. I believe Humble has always had a headquarters building in Houston and we were in a building which we owned. And when the new building was built, why, it was moved to the new building.

Q. Has Humble counted on the U. S., United States population explosion, to provide better markets for its resources and crude petroleum and natural gas?

A. Well, to the extent, of course, that population increases and has a demand for petroleum products, that is a factor that we have to take into account in our forward planning.

Q. Do you know the extent of direction and control of the refining function at Houston?

A. Well, let me say that the Vice-President in charge of Refining in Houston is responsible, of course, for the overall coordination of the manufacturing activities at each refinery. An operating program has developed for each refinery and the managers of those refineries have responsibility for conducting their operations in the way that gets the most efficient and effective implementation of that operating program.

Q. Mr. Luper, as a part of the executive training program isn't there considerable interchange of officers and major employees between departments?

Mr. Ragatz: I think I will have to object to that on the basis of foundation. There has been no testimony that there was any executive training program.

By Mr. Shapiro:

Q. Is there such a training program or was there during the period in issue?

A. Well, there was no formal program if that is what you are referring to.

Q. But is there interchange of personnel to carry out the idea of executive training?

A. Yes.

Q. Between departments?

A. Yes. Not on a program basis but on an individual basis.

Mr. Morris: Would you repeat the answer.

The Witness: I replied that, yes, there were transfers of employees between departments, but not on a formal program or overall program, but just case by case.

Q. It is a company policy to transfer employees between departments on a formal basis?

A. As a matter of procedure we do that, yes.

Q. Now, with respect to transportation and traffic, what transportation policies are set at the home office in Houston?

A. Well, again this is a broad question because we have different methods of transportation.

Q. I will be specific. For example, if there is an initiation of a new or different method of distribution such as a barge ship or rail distribution system, is that policy established at Houston?

A. I wouldn't refer to it as a policy. It is a practice or an arrangement. It would be developed by the Marketing Department with consultation with the Supply Department; and when a plan had been devised, if that required additional transportation facilities, then the appropriate department would be brought in to provide it.

Q. With reference to Exhibit 20 again, you indicated supply and corporate staff would be involved. What other categories; would it be corporate planning?

A. No, as I said, it's a group in supply.

Q. I thought you indicated some other function.

A. The marketing people, of course, are interested in the distribution function.

Q. Any other function in the corporate staff? Might the treasurer be involved for acquisition of equipment?

A. No, the treasurer wouldn't be involved unless there was some question of financing or if there was a question of tax treatment, why, of course, the tax staff would be consulted.

Q. And if it is a major development such as an installation of new pipeline facilities, it might go to the Board of Directors?

A. It would go to the Board of Directors of the Exxon Pipeline Company.

Q. I see, but the transportation facilities within Humble are other than pipeline?

A. Well, as I explained this morning, the Marine facilities are a part, are a segment of the operating functions in Humble. The pipeline transportation facilities are owned and operated by the Exxon Pipeline Company, which was at that time known as the Humble Pipeline Company.

Q. How do you define a vertical integrated petroleum company?

Mr. Ragatz: I am going to object to this inquiry on the basis that it sounds like a question that you would ask an expert economist, not a businessman, and I think Mr. Shapiro will have his chance to ask our expert witness that kind of question, and I don't think we should impose that kind of question on this witness.

Mr. Shapiro: The witness seems highly qualified to answer that.

Mr. Ragatz: I appreciate the compliment to his qualifications, but I don't think we can classify him as an economist.

Mr. Morris: Do you understand the question?

The Witness: I understand the question.

Mr. Morris: Can you answer the question?

The Witness: Not if the question involves a legal interpretation or economic interpretation.

Mr. Morris: Does it involve a legal conclusion or an economic conclusion?

Mr. Shapiro: No, sir.

Mr. Morris: Would you repeat the question and specifically state how you wish the question answered?

By Mr. Shapiro:

Q. Mr. Luper, how would you define the term vertical integrated petroleum company?

A. Well—

Mr. Ragatz: Let me interpose my objection so I can ask for a ruling on it as to whether that doesn't—first of all, it's an opinion that only an expert economist is probably qualified to give. It is a very technical term involving a very technical subject, and I don't think it would be any more fair for counsel to ask him that question than for me to ask his auditor to try to define that term so I would ask for a ruling that the question be deferred and asked of our expert economist when he takes the stand.

Mr. Morris: Again, I am noting your objection, Mr. Ragatz, and noting possibly the limited experience in defining the term, do you understand the term and to the best of your ability can you answer that question?

The Witness: Well, if I can answer it in the way I understand it from just a businessman's point of view, but not from an economic or legal context.

Mr. Morris: Is that sufficient?

Mr. Shapiro: Yes, sir.

Mr. Morris: You may answer the question if you understand it.

The Witness: As I understand the question and without providing any legal significance or economic significance, I believe the term is normally applied to a petroleum company that is involved in all the major operating functions, principal operating segments of the business.

By Mr. Shapiro:

Q. These segments would be the E and P, Refining and Marketing, to name the three major ones, is that correct?

A. Yes.

Q. Mr. Luper, as an officer of the company and in view of your responsibility to stockholders, you are concerned very directly with the overall profits of the entire company, are you not?

A. Yes, I am.

Mr. Morris: At this time we will take a ten-minute break.

(Recess, 3:30 p.m.)

Q. Mr. Luper, in your direct testimony you stated several advantages of being included under one corporate entity, and including stability of operation, spreading of risk, attraction of high quality of staff personnel, and isn't another advantage——and this would apply to a vertically integrated company—the transfer pricing options available that give an opportunity to move profits from one activity into another.

Mr. Ragatz: I am going to object to that. That question, I can't see, has any bearing whatsoever on a tax controversy. That sounds like an anti-trust question to me, and that is well beyond the scope and jurisdiction of this proceeding, and if the Commission were deemed to require

the answering of that line of questioning, I would want to ask for a recess and consider whether or not I would instruct the witness to answer that question or whether I consider it an interlocutory appeal. This is not an anti-trust proceeding; this is a tax proceeding. That kind of inquiry has no basis in this proceeding.

Mr. Shapiro: I fail to see the reason why counsel is so upset with an anti-trust notion unless it is because of the presence of an expert witness for the respondent, but this question relates to functional profits and the entire theme of the petitioner's case is that they take their profits on a functional basis, so that this question is very relevant to the overall operation of the company.

Mr. Ragatz: If he wants to ask the witness, "Do they shift profits" I don't have any objection to that question, but if the overtone of the whole thing is that of an anti-trust inquiry, I vigorously object to it. The question itself was not directed to Humble. It was stated in terms of "Does a vertically integrated company do this." If Mr. Shapiro wants to ask the question, "Does Humble do this," then this witness can give him an answer. If he is asking for industry-wide economic views, I don't think this witness can give him an answer.

The Chairman: You object to the broadness of the question?

Mr. Ragatz: I object to that particular question, and I will withdraw it if Mr. Shapiro wants to rephrase the question directing it to Humble, I would then withdraw the objection as to that question, but certainly the objection to an anti-trust line of inquiry.

By Mr. Shapiro:

Q. Does Humble have options available to it that gives it the opportunity to move profits from one activity to another?

Mr. Ragatz: I have to object to that. That is argumentative. If he wants to ask "Does Humble shift profits back and forth," that is a question the witness can answer. If he wants to argue that profits are shifted, he can do that in the brief.

Mr. Shapiro: We are referring to options.

The Chairman: Are you rephrasing the original question that an objection was raised to?

Mr. Shapiro: Yes.

The Chairman: You are withdrawing the original question?

Mr. Shapiro: Yes.

The Chairman: And now you are rephrasing the question as to apply to Humble?

Mr. Shapiro: Yes, sir.

The Chairman: And you are objecting to it?

Mr. Ragatz: My objection is, if he wants to ask the question, "Does Humble do this," I will withdraw the objection. If you want to ask an economics question which has an anti-trust ramification and not tax ramifications, then I will pursue my objection.

The Chairman: Will you please state the question or have the question reread?

(Question read: Does Humble have options available to it that gives it the opportunity to move profit from one activity to another?)

The Chairman: Do you understand the question?

The Witness: I heard the question, yes, sir.

The Chairman: Are you able to answer it?

Mr. Ragatz: Mr. Chairman, are you overruling my objection? The form of the question still is objected to as

far as I am concerned. He is asking for an opinion of this witness as opposed to asking for an objective fact. This witness is not here to testify as to opinion. That is for an expert witness economist, and if you want to ask the question, "What is the fact," then I won't object to it. If he wants to ask for an opinion, I don't think this witness can answer that.

Mr. Shapiro: The witness is an executive of the company, and asking whether options are available to the company is not an unfair question.

The Chairman: Let me counsel with my attorney.

(Recess)

The Chairman: We will sustain your objection to the question, Mr. Ragatz.

By Mr. Shapiro:

Q. Mr. Luper, how is the supply of packaged oils and greases and similar items obtained? I will add this question: Humble manufactures packaged oil and greases, does it not?

A. Yes.

Q. Now, do you have Exhibit 21, the map?

A. Yes, I do.

Q. Do you know of what plants or refineries the packaged oils and greases are manufactured?

A. For general distribution?

Q. Yes, sir.

A. I know some of them. There are packaged materials of the Dayton refinery, at Bayway, and I believe at Baton Rouge.

Q. Now, the source of raw materials for the production of these products would be Humble's own produced crude oil, at least in part, would it not?

A. It could be in part.

Q. Is it true that an integrated company, such as Humble, that is deficient on crude operates at a disadvantage as compared with a company that is not deficient on crude?

Mr. Ragatz: Objection. What is the relevance of that inquiry?

Mr. Shapiro: The relevance is that the supply of crude is an important factor in the source of raw materials.

Mr. Ragatz: Well, that is your opinion and that you can argue, but I don't understand what you are asking this witness unless you are asking his opinion.

Mr. Shapiro: This gentleman is an expert in his field and that field is oil and gas.

Mr. Ragatz: He is not an economist, and you are talking—that is an economics question you are asking.

Mr. Shapiro: He testified as to the stability of the operations as being one benefit, being in one corporate entity.

Mr. Ragatz: He is talking about Humble.

Mr. Shapiro: Yes.

Mr. Ragatz: And your question doesn't relate to Humble; your question was any company. I am not—he can testify as to facts as to Humble, but I don't think he can testify as to the opinions as to how things work in the industry. If he knows facts of the industry, he can testify to that.

Mr. Shapiro: Well, I will rephrase that question.

By Mr. Shapiro:

Q. If Humble were deficient on crude, would you consider that as a disadvantage.

Mr. Ragatz: I guess I would stipulate that if Humble or anybody else was deficient on crude, in the industry that would be a disadvantage. I guess I don't understand the question.

The Chairman: Can you answer the question.

A. Well, presuming that the refinery did not acquire the crude in another manner, yes, it would be a disadvantage.

Q. Would that disadvantage be reflected in all departments, all major departments of the company?

A. I don't see how it could.

Q. Mr. Luper, the federal deletion allowance is based on net income from production, is it not?

A. Yes.

Q. And such net income is completed before any so-called downstream activities are involved, such as refining or marketing, isn't that correct?

A. The deletion allowance is based upon well head value of the crude.

Q. So that the E and P net income must be determined for purposes of the federal depletion allowance, isn't that true?

A. The revenue from production of oil and gas must be determined, and that is in the operation or within the operation of the E and P function.

Q. And the larger profit that results, the greater is the amount of depletion allowance within certain limitations?

A. I never encountered any profit from the payment of taxes, Mr. Counsel.

Q. I am referring to reduction of federal income taxes.

A. If you mean the tax benefit?

Q. Yes, sir.

A. Would you please restate your question?

Q. The larger that income is, the greater the tax benefit, the greater the tax benefit would result in the form of a depletion allowance?

A. Yes, the larger the revenue from crude oil and gas, the larger the depletion allowance and therefore the larger the tax benefit.

Q. Doesn't the home office at Houston have experts in economics and marketing who provide services for assessing the desirability of putting new service stations in a given area?

A. The staff is available to the vice president of marketing, it is competent to give him advice on location of new service stations.

Q. Does the home office put out circulars covering changes in laws such as workman's compensation, unemployment compensation, wages and hours, social security and that sort of thing?

A. Well, as a service for all or each of the operating functions, one of the corporate staff departments, probably Employee Relations or perhaps Tax, would advise the vice presidents and general managers of the operating departments and then each of them would have its own administrative staff prepare the necessary information for the benefit of its field organization.

Q. Do you have any knowledge, sir, as to how a product came into Wisconsin in 1968 or during the years in issue?

A. 1968?

Q. Yes, sir.

A. I have only a general knowledge.

Q. Was gasoline carried into Wisconsin for Humble by the West Shore Pipeline Company?

A. It is my understanding it was.

Q. And was some of that product carried from Hammond, Indiana?

A. It may have been. I really don't know.

Q. And was some of it carried from Romeoville, Illinois?

A. It may have been. I still do not know.

Q. And did Humble obtain such gasoline pursuant to an exchange agreement?

A. It is my understanding that it did.

Q. And with what company or campanies?

A. Well, it was at that time I believe—it was the Pure Oil Company was one of the companies.

Q. Are you aware of any others, sir?

A. I am not aware of any others at that time. I am not certain that is the only one.

Q. Do you know where those exchange agreements were negotiated?

A. No, I do not.

Q. Do you have any understanding as to where they might have been negotiated?

A. I would presume they were negotiated in the Houston office of the Supply Department.

Q. Do you have knowledge as to the location of the terminal at Jones Island in Milwaukee, sir?

A. I haven't heard of Jones Island.

Q. Do you know whether Humble had a terminal-link agreement with Phillips Petroleum Company at Jones Island?

A. I understand that there was one.

Q. And do you know whether that agreement was in writing?

A. No, I do not.

Q. Do you know what official of the company would have negotiated such a terminalling agreement?

A. No, I do not.

Q. Do you know whether the product was cased by the West Shore Pipeline Company into Wisconsin and destined for Green Bay, Wisconsin?

A. I do not know. I assume that it was. It could have been but I don't know that for a fact.

Q. Did Humble have a terminalling agreement with Cities Service Oil Company at Green Bay?

A. It's my understanding that they did.

Q. And do you know what official of the company would have negotiated that agreement?

A. No, I do not.

Q. Was there a transportation agreement in existence between your company and West Shore Pipeline Company?

A. There will be another witness on tomorrow who can answer that factually. I would be surmising.

Q. During the years in issue do you know approximately what per cent of sales in Wisconsin were derived from sales of gasoline?

A. No, I don't have that information at hand.

Q. Or, stated another way, what per cent was derived from sales of TBA greases and lubes?

A. I don't have that information.

Q. Can you explain what personned managed a terminal and how many persons are involved?

A. No, I am not familiar with that operation.

Q. There were approximately 350 retail outlets in Wisconsin during this period, isn't that correct?

A. I don't know the number but that may be in the range.

Q. And in addition to that there were two or more Car Care Centers in Milwaukee and other areas?

A. I do not know that for a fact but I would not be surprised.

Q. Who would have the final authority to determine whether a Car Care Center were to be opened?

A. If you are referring to Wisconsin the regional manager of the Central Region.

Q. Now it is the supply part of the corporate staff that arranges for the crude oil process at Humble refineries, is that correct, sir?

A. If you would just explain your question I would understand it.

Q. Did you ask me to explain it?

A. Yes, elaborate on it.

Q. Oh. The corporate staff that you have indicated as supply, does that function arrange for crude oil delivered to Humble refineries?

A. It would be the Department who would plan and develop a program for that movement.

Q. When you look at Refining and E and P together, is it true that Humble can make a larger profit per barrel from crude oil that Humble produces and refines than it would from crude oil that is purchased and refined?

A. Well, as far as the profit on the crude oil produced by Humble, product by E and P, it would be profit-related to the production of that oil. Any profit made by the Refining Department, whether its from oil produced by Humble or oil purchased from another producer, is derived from the investment in and the operation of the refinery.

Q. One of the major reasons for Humble owning its own refineries is to process its own produced crude oil, is that true?

A. I testified this morning that the attractiveness of refinery investments are directly related to a stable and assured supply of crude oil and raw materials.

Q. If it costs, for example, two dollars to take a barrel of crude out of the ground and the posted field price is four dollars, then E and P has a two-dollar profit on that, is that correct?

A. Well, I don't know what you—if you are just defining the four dollars as the revenue and the two dollars as the entire cost and operating cost to go with it, why obviously the difference is two dollars.

Q. Well, I am asking whether, if it costs two dollars to take a barrel of crude out of the ground and the posted field price for that barrel of crude is four dollars, then there is a two-dollar profit to E and P, is that right?

A. I can only tell you that the two dollars to E and P only results if the two dollars is the complete cost including all taxes and everything else.

Q. Yes, sir. We are assuming that. And then that barrel of crude would be charged to the Refining Department at four dollars, would it not?

A. Whatever the posted prices was plus the appropriate pipeline tariff for transportation to the refinery.

Q. And if the refining costs is a dollar added to the four and the wholesale price to marketing is 5.50, there will be a 50-cent refining profit, is that true?

A. I haven't followed your arithmetic. It is kind of complicated.

Q. Well, I am trying to keep the numbers real simple.

A. Well, I have a pencil. Refining paid four dollars for the crude?

Q. Yes, sir. We assume that four dollars was the posted field price and that it would be charged to refining at four dollars.

A. Including the transportation?

Q. Yes, sir.

A. All right.

Q. And then the cost of refining is a dollar added to that, and the wholesale price, when it's transferred to Marketing, is 5.50. Isn't there a 50-cent refining profit?

A. Yes.

Q. Now let's take it one step further and assume that in Marketing the cost is four dollars added to the five. Well, it's charged to marketing at 5.50, is it not?

A. Yes, plus transportation.

Q. Yes, sir. And we add four dollars as marketing costs which brings it to 9.50 for the quantity of fuel that is refined from that barrel of crude. Let's suppose that Refining sells that for nine dollars. There is a 50-cent loss to Marketing—I should say Marketing sells it for nine

dollars, then there is a 50-cent loss to Marketing, is that right?

A. According to your figures.

Q. Yes, sir. Now previously in Refining we have had a 50-cent profit and in E and P a two-dollar profit. That's 2.50. And then you net a 50-cent loss, so the net profit to the company would be two dollars under those assumed facts, is that right?

A. Before taxes?

Q. Yes, sir.

A. And the other overhead costs perhaps, that's right.

Q. Yes, sir.

Q. With respect to exploration, Mr. Luper, the division office for the area that Wisconsin happens to fall in is Oklahoma City, is that correct?

A. Let me see. In this period of time it might have been Oklahoma City or it might have been Tulsa. I am not entirely positive.

Q. Do you have knowledge as to the structure of that Oklahoma City Division Office, as to the number of employees and functions?

A. No, I have knowledge of the functions, but not of the number of employees.

Q. Will you state that, sir?

A. Of the Exploration Office, of the Division Office?

Q. Yes, sir.

A. It was the Division Field Office of the Exploration Department. It was a self-sustained contained unit in the geographic area assigned to it, and it was responsible for implementing the exploratory programs for that particular geographic area.

Q. And is that headed by a manager?

A. A manager, yes.

Q. And to whom is the manager responsible to?

A. Well, he is responsible to the Vice-President of Exploration reporting through an operations manager that is an assistant to the vice-president.

Q. Within the scope of the manager's authority would he have authority to enter into new leases?

A. Yes, he would.

Q. And explore new areas?

A. Yes.

Q. And expand on exploration within certain limits?

A. What do you mean by "expand on exploration"?

Q. Expand with respect to investments.

A. Here again he is operating within a program and if he should decide or desire to go into a new geographical area that was outside this program, then, of course, he would have to discuss that with the Exploration Vice-President.

Q. And supposing that a significantly more aggresive and active exploration activity was contemplated, who would have the final approval of that?

A. If that involved a substantial expenditure of money it would be incorporated in the budget and that budget, as I said before, would essentially be approved by the Board of Directors.

Q. In the early 1960's Humble had more crude than its refined product market could absorb, isn't that true?

A. I haven't looked at that data and I can't tell you for sure.

Q. Isn't it also true that the company decided to expend large sums of money in order to look for more crude at that time?

A. I believe it has been the company's policy as long as I can remember to always spend the money for prospects for new oil and gas reserves where we thought it was a profitable activity.

Q. Is it true that the officials of the company believed that the oil consumption was going to grow a lot faster than anyone expected in the future and the instructions were to locate, explore and locate and find all the oil you can?

A. I can't speculate what the officials of the company thought would be the future consumption trend, but Humble Oil and Refining Company has always been a company interested and willing to invest in the search for new oil and gas reserves.

Mr. Shapiro: Off the record.

(Discussion off the record.)

Q. The company official that coordinates refining operations throughout the United States would be the vice-president for Refining?

A. Yes.

Q. Now, a refinery is operated continuously, isn't that true, except for brief periods of shutdown?

A. Yes, that's correct.

Q. And that shutdown is for maintenance purposes?

A. Usually.

Q. And there must be a continueous supply of crude available for the economic operation of the refinery, is that true?

A. Adequate supplies to operate the refinery must be available.

Q. Is the crude stored in large tanks outside the refinery?

A. Well, it is stored in large tanks. Some are outside the refinery.

Q. Doesn't the company have an economic incentive to refine as much of its own crude as possible?

A. No. As far as profit to be derived from a manufacturer of barrel crude, it would be the same whether we obtained it from the production from our own produced

crude or whether we purchase it from the outside for the very simple reason that we have had to make an investment in that refinery to produce that barrel of crude.

Q. Now, the annual reports of your company that are in the record show refinery crude oil runs at, for example, 900,000 barrels a day. Now, in order to obtain the total barrels transferred to a refinery for a year, would you multiply the 900,000 by the number of days the refinery operated during that year or by some other number?

A. I am not familiar—I don't have in front of me the data that you are looking at. Are you asking an exact question or a hypothetical question?

Q. Well, I prefer not to take the time to go through the annual reports, but if for the moment we can assume that 900,000 barrels a day is a refinery's crude oil run total—

A. Total crude oil run?

Q. Yes, crude oil run.

A. Yes.

Q. Now, that is on a daily basis?

A. Yes.

Q. In order to obtain the total barrels transferred for a year, what would you multiply it by, 365?

A. To get the total barrel run in a year, by 365.

Q. I see. Now, again let us assume that the total production of crude in a given year, say, 1965, was 200 million barrels and 65 million barrels were sold at the lease and the remaining 135 million barrels were transferred to supply and that an additional 300 million barrels were purchased, now, I would like to ask you with respect to the 65 million barrels sold at the Lease, to what extent would these sales have been made pursuant to the exchange agreement?

A. I would have no way of knowing what percentage. There will be a witness on tomorrow who may have some information on that matter.

The Chairman: Off the record.

(Recess.)

The Chairman: On the record.

By Mr. Shapiro:

Q. Mr. Luper, there are some 23,000 wells in the producing states, isn't that correct?

A. I don't have the figure at my fingertips, but that could be correct.

Q. It sounds reasonable?

A. Yes.

Q. I have taken the 1967 annual report from Mr. Sheridan's work papers, and on Page—you are familiar with the company's annual report, sir, are you not?

A. If that is in '67, it has been seven years since I have seen it.

Q. I meant in a general way. I refer you to Page 7 and the statement that reads—

A. This is the annual report of Standard Oil Company of New Jersey, not the Oil and Refining Company.

Q. That is correct, this is referring to the United States operations here, sir. It says, "With reference to the United States operations of Humble Oil and Refining Company, despite production increases Humble continues to have the largest domestic oil and gas reserves of any company in the nation, and thus remains in an excellent position to participate in supplying increasing demand."

A. Yes.

Q. Doesn't that indicate a contribution of the E and P Department to the Marketing Department—

Mr. Ragatz: Objection. I think the document speaks for itself, and I think he is again asking an opinion and that opinion has a legal conclusion written all over it.

The Chairman: Do you want to answer Mr. Ragatz' objection?

Mr. Shapiro: Well, I am asking for the judgment of the witness. He is an expert businessman.

The Chairman: I think the record speaks for itself and I don't believe that it is necessary to answer that question. The objection is sustained.

By Mr. Shapiro:

Q. Isn't it true, Mr. Luper, that the Refining and Marketing Departments represent a means to get crude oil produced?

A. No, I wouldn't see how that would follow.

Q. I didn't hear your answer.

A. I don't see how that could follow.

Q. For the period in issue, 1965 through 1968, what was the—in your best estimation, what was the percentage of return on investment for E and P, Refining and Marketing?

Mr. Ragatz: Combined?

Mr. Shapiro: No. For each one.

Mr. Ragatz: If you know.

Q. If you know.

A. That is a year—I have made no preparation to give you a figure on that.

Q. Would you hazard a guess?

A. I prefer not to.

Q. The packaged lubricating oils and greases and industrial oils and greases that were manufactured by Humble were sold in Wisconsin, isn't that true?

A. I believe that is true.

Q. Off the record.

(Discussion off the Record.)

Q. No further questions at this time.

The Chairman: Mr. Ragatz? Redirect?

Mr. Ragatz: Just a couple of quick questions.

Examination

By Mr. Ragatz:

Q. Mr. Luper, cross-examination raised the question of transportation facilities. Does much of the crude and gasoline that is transported in connection with the Humble operation get transported by facilities not owned by Humble, or did it during the years in issue?

A. Would you restate that, please?

Q. Maybe I can make it clearer. The transportation of crude—

A. Excuse me—

Q. —and gasoline—

A. Excuse me. Would you separate it between crude and gasoline?

Q. Let's take crude—the transportation of crude is taken mostly through pipelines?

A. Yes.

Q. And were these pipelines owned by Humble Oil and Refining Company?

A. No.

Q. And how about gasoline? How was that transferred and in whose facilities?

A. Gasoline was transferred in a number of ways; gasoline was transferred by pipeline and transferred by tanker and by barge. As I have testified, the products that were transported in Humble-owned equipment was the marine equipment, but those that were transferred by pipeline was by—by some pipeline, it could have been Exxon at Humble.

Q. Or other pipelines?

A. Or other pipelines.

Q. Mr. Shapiro also asked you about a concern about profits for the shareholders. Would you comment on the concentration of profit concerns by functional departments as being the primary source of profit concern?

A. Well, of course the profits of each of the individual functional segments go into determination of the overall consolidated profits and as such, why obviously the functional profits are important to us, as well as the overall corporate profits.

Q. Profits are determined by function—in accordance with your functional profitability independence policy?

A. Yes.

Q. You were asked about the determination of the depletion deduction and its impact. Now, do you or do you not use the same or similarly-determined well head values for purposes of calculating the royalty interest that you have to pay the third-party royalty owners?

A. Yes.

Q. And do you use the same determined values for calculating the amount of the working interests that you have to pay the owners of those working interests?

A. For the value of their share of production?

Q. Correct.

A. Yes.

Q. And do you use the same determined values to arrive at the amount of the severance taxes that you must pay to the various states in which the production occurs?

A. Yes.

Q. Now, are these profit benefits or profit detriments in each case?

A. Well, in each case to the extent that they are cost, they are economic detriments.

Q. No further questions.

Mr. Shapiro: May I ask one question?

Examination

By Mr. Shapiro:

Q. Mr. Luper, in your experience as a certified public accountant and your broad experience in business, isn't it

common for corporations to transfer product from one division to another for further processing to have profit centers?

Mr. Ragatz: Would you read that back?

(Question read.)

Mr. Ragatz: That is what I thought he said. This witness is not qualified as an expert in the business of all kinds of companies. His background clearly indicated that he has been with the Humble Oil and Refining Company and related companies for—I forget how many years—and I don't think that he is qualified to give an opinion as to what businesses do generally, despite the fact that he is highly well-qualified by education and experience in the business of Humble Oil and Refining Company, so I would object to that quetsion as asking for an opinion evidence that this witness is not qualified and under these circumstances—

Mr. Shapiro: I submit it is a fair question on the basis of business judgment.

Mr. Ragatz: I guess you would agree, you are asking for an opinion, though?

Mr. Shapiro: No, it isn't. It is a matter of fact as to whether profit centers are established in other corporations that I referred to. That is a factual question.

By Mr. Shapiro:

Q. From your own knowledge, Mr. Luper, did—

Mr. Ragatz: Let me inquire, did you refer to corporations generally or to the oil industry?

Mr. Shapiro: I am not restricting it to the oil industry.

Mr. Ragatz: Then my objection stands. If you want to ask about the oil industry, maybe he does know, but I don't think he can answer as to the corporation generally.

Mr. Shapiro: He is a member of various professional societies and he has broad experience in business.

The Chairman: I will sustain the objection. Anything further?

Mr. Shapiro: No, sir.

The Chairman: There being nothing further, it is 4:45 and we will adjourn the hearing until 10:00 o'clock on Monday morning in the same court room.

Mr. Morris: Before we adjourn, will we need this witness for any further testimony in this hearing?

Mr. Ragatz: No.

Mr. Shapiro: No.

Mr. Morris: Mr. Chairman, then I would assume you can excuse this witness for any further testimony.

The Chairman: I assumed he was excused. We will excuse you formally, sir.

(Witness excused.)

(This matter was adjourned to 10:00 A.M., Monday, October 7, 1974.)

STATE OF WISCONSIN

WISCONSIN TAX APPEALS COMMISSION

Docket No. I-3806

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),

Petitioner,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

CERTIFICATION

KAREN A. CHERRY
MINDLA COMINS
LORETTA PETERS,

hereby certify that as the duly appointed reporters, we took in shorthand the testimony and proceedings had in the foregoing matter on the 4th day of October, 1974, and that the attached is a true and correct transcription of said shorthand notes and of the whole thereof.

Dated this 4th day of October, 1974.

Karen A. Cherry
Karen A. Cherry

Mindla Comins
Mindla Comins

Loretta Peters
Loretta Peters

TRANSCRIPT OF PROCEEDINGS in the above-entitled matter held before the Wisconsin Tax Appeals Commission, in Room 229, City-County Building, Madison, Wisconsin, on the 7th day of October, 1974, commencing at 10:00 in the forenoon.

Mr. Morris: We will continue the hearing regarding the above matter.

Mr. Ragatz, you have a request to make before you call your next witness?

Mr. Ragatz: For purposes of the record, I am not sure that on late Friday afternoon the record would show that Mr. Luper was excused as a witness with consent of counsel for the respondent.

Also on Friday there was discussion of the production of certain documents if they were found to exist, and I want the record to show that this morning I provided Mr. Shapiro with a copy of an exchange agreement with Pure Oil Company that we understand affected products coming into Wisconsin. I also advised him that our people have advised me that there was no exchange agreement with Shell Oil Company and that the Cities Service agreement did not affect the years here in issue. The Shell agreement and the Cities Service agreement, having been requested by counsel for respondent, we will have a witness here today who can be questioned by counsel for respondent on that subject.

Mr. Shapiro: And after we have had an opportunity to review the exhibit, we will take into consideration whether we want to introduce it into the record.

Mr. Morris: It is not part of the record at this time.

Mr. Shapiro: Not at this time.

Mr. Ragatz: I will deem, unless advised otherwise, that we have complied with the request for production of copies of applicable exchange agreements.

Mr. Morris: On the question you raised of Mr. Luper, whether he was excused or not, I think it was ruled on Friday that he was excused and there is no reason for any further testimony from Mr. Luper. That ruling will hold unless there is a reason to have Mr. Luper called back.

Mr. Shapiro: Did I understand you to say we raised a question?

Mr. Morris: No. Mr. Ragatz raised a question on whether he was excused or not.

Mr. Ragatz: It was our impression that he was, but I wasn't sure that the reporter was still taking transcript on that point, so—

Mr. Morris: So the record will reflect that Mr. Luper completed his testimony and he was excused and there was no objection on his excusal by either party.

Mr. Ragatz, you may proceed.

Mr. Ragatz: The petitioner calls John G. Jeager.

JOHN G. JEAGER, called as a witness, having been first duly sworn under oath, testified as follows:

Examination

By Mr. Ragatz:

Q. Please state your full name for the record.

A. John Glen Jeager.

Q. Where do you live, Mr. Jeager?

A. Houston, Texas.

Q. How old are you?

A. Fifty-eight.

Q. Would you summarize your educational background?

A. I attended Rice University in Houston, graduated with a Bachelor of Science degree in Mechanical Engineering. I have attended the Advanced Management School at the University of Pittsburgh in 1960, and in 1968 I attended the Brookings Institution School for Managers.

Q. What professional societies do you belong to?

A. I belong to the Society of Petroleum Engineers, the American Petroleum Institute, the Mid-Continent Oil and Gas Association.

Q. What is your present occupation?

A. I am a petroleum consultant.

Q. How long have you been so engaged?

A. Just one month.

Q. What did you do prior to that?

A. For 38 years I was with Exxon. I had a number of positions starting in the Gas Department and field work later as a gas engineer, and then a superintendent in charge of the gas operations in the area east of the Sabine River. I then went into the Production Department where I had —I was Assistant Division Manager in charge of producing operations in the on-shore area of Louisiana and Mississippi; and in 1961 I became manager of the Crude Oil Department of the Humble Oil and Refining Company, moved to Houston, and, well, for five years I was manager of Crude Oil; and then in 1965 I assumed also the responsibilities for supply, commerce arrangements for bulk products and gas liquids as well as crude oil.

Q. Did you continue in this position until your retirement?

A. That was the position I had when I retired on the 1st of September of this year.

Q. That would include the entire period in issue, 1965 to 1968?

A. Correct.

Q. Now would you describe a little further the duties and responsibilities of that position?

A. The principal responsibility was to manage the crude oil supplies of the company in the United States. This broadly covered the disposition of all the company's

produced crude and responsibility to say that the company's refineries had adequate supplies of the proper types of crude to meet their requirements, the carrying out of these responsibilities, and the group under my supervision bought and sold crude oil all over the United States. We sold our own production and we bought oil as needed to fill out the requirements.

Q. How many years of experience have you had in the oil and gas industry?

A. Thirty-eight years.

Q. Now in addition to what you have already described as your position, what were the functions of Humble's Supply Department with respect to crude oil during the years in issue?

A. Well, in addition to the movement of crude, that is the buy and sell, the transportation activities, we had some planning responsibilities with regard to expansion of refineries, what future supplies might be, and we had responsibility to appraise the market to determine what proper prices should be for the crude oil, and it was my group that would develop pricing strategies and pricing—actual pricing changes that would be made, and recommend such changes to the Board of Directors.

Q. What was the function of the Supply Department in respect to crude oil in connection with the interests of royalty owners?

A. Well, the Supply Department bought crude oil from royalty owners. The purchases I spoke of a while ago included purchasing crude from royalty owners, purchasing crude from non-operating working interest owners under Humble-operated properties as well as purchasing crude from other producers.

Q. Would you explain just briefly the interest of a royalty owner in a particular well or in a particular lease

and also the relationship of the joint working interest, just for background for the Commission?

A. All right. The royalty owner under a lease is the owner of the mineral interests. There are, generally broadly, two interests in a lease. There is a working interest and a royalty interest. The working interest usually is represented by the oil company or the producer. The royalty interest usually is the land owner, and when a land owner leases his land to a producer, he retains some interest in the minerals that will be recovered from the land, and that is what we call "royalty."

Now he retains that—in the case of oil, the royalty owners retain the interest in percentage of the oil produced, such that he owns the oil when it is produced, and hence someone has to buy that oil from him, unless he has reason to use it himself, and of course it is always the case that the royalty owner sells his oil under contract and the purchases I spoke of were the purchases we made from royalty owners of the so-called royalty interest.

Q. Would you also explain the operation of a joint working interest?

A. The second category, joint working interest, it is very frequent in the oil field that several companies will own a producing property for a number of reasons, but always one company is selected to be responsible for the operation of the property, that is the drilling of the wells and the producing of the wells to see that the equipment is there, the people are there, and all the supplies are delivered and handled right, and then the operator has some responsibility to see that the production is moved to the lease when the production begins.

Now each of the participating producers in this joint property has the obligation to take his production away from the lease. Frequently they produce—the non-operating producers choose to have the operator make the sale of oil for him. The mechanism to use is the operator buys the oil from the non-operator, and then turns around and sells it in the market.

Q. Now who determines what portion of the Humble-produced crude would be transferred to the Humble Refining Department during the years in issue?

A. Well, there is no such determination made, as such. There was a distinct break between the disposition of produced crude and the acquisition of crude for the refineries.

Q. What factors were considered in determining whether you would dispose of Humble-produced crude or whether you would transfer it to the Humble refinery?

A. There are three principal factors. First would be location of the production; that is is it near a refinery or near a transportation system which could economically move the crude to a refinery.

Secondly, the quality of the crude. Actually the crude, any crude that goes into a pipeline system loses its identity as to the origin. It is identified only as to quality.

Humble produced crude then would be disposed of in the most economical market.

Q. Is there any policy of the company that required you to transfer Humble produced crude to the Humble Refinery Department?

A. No.

Q. Was that Refining Department required to acquire its crude from the Humble E and P Department?

A. No.

Q. Who determined that transfer price when Humble produced crude was transferred to the Humble Refining Department?

A. Humble produced crude was always transferred to the Supply Department on the basis of a posted field price for the field in which the crude was produced.

Now, when the Humble produced crude then was in the pipeline system, it moved where the most desirable market might be, and in some cases that might be a Humble refinery.

In other cases, it would be a sale to other refineries, but there was never any identification of the crude origin after it entered the pipeline.

Q. Did the Humble E and P Department have any say in setting that posted field price at which crude was transferred?

A. No.

Q. Did the Humble Refining Department have any say in setting that price?

A. No, they did not.

Q. Would you explain the concept of a posted field price?

A. A posted field price is a published price at which a company, or which a company is willing to pay for crude that it may buy in a particular field. The price applies to all purchases of that particular crude, but it is not a commitment to buy. It is only a publication of the price at which crude will be purchased if it is purchased.

Q. How is the price determined?

A. The determination really begins in the product market. The price of products is backed through the refinery cost of manufacturer including the cost of distribution of the product and the cost of manufacturing of the product, and then the cost of transporting the crude to the refinery back into the posted field price.

Now, of course, you don't go through that complicated pricing mechanism every time you study posted prices because the system is already established so really the current method of determining a posted price under the established system is what are the competitors paying.

If a company needs crude, they have to pay the competitive price.

Q. Who generally determines this price?

A. Well, the Supply Department did that. That is part of my responsibility, to determine what Humble had to pay in order to buy the crude it needed.

Being a buyer, we were interested in buying at the lowest price, but we couldn't pay less than the market and get the crude we needed.

Q. In any particular field what determined what the posted field price was?

A. In any particular field, again the price—assuming we would be the only poster in a field, the price would be the going price for similar crude in the market having to do with quality, location of the crude.

Q. Is there likely to be more than one posting in a particular field?

A. Many times there is more than one posting when there is more than one purchasing company.

Q. How would the prices of the various companies compare?

A. They are usually the same.

Q. Would you explain that?

A. Yes. As I said a while ago, a company who wants to buy crude, they, of course, want to buy it at the lowest price so they—in order to keep the price down. On the other hand, if there is competition in the buying, that tends to drive the price up, but there is an upper limit to what the company can pay because of the cost of moving to the refinery, manufacturing the product, and then competition in the product market.

Now, all these factors get worked into what the industry, the competitive prices will be in any particular field.

Q. Now, to what kind of an area does a particular posted price apply?

A. There are two broad types of posting. One is for a field, and, secondly, for an area such as the South Louisiana Offshore, which represents quite a large volume of production and generally a company will post one price for all offshore production.

Q. Define what you mean by a field.

A. A field?

Q. A field.

A. Technically a field is a producing area, geographical area under which there is oil and in which there are wells producing the well. In some cases, particularly in Texas, a field might be designated as a reservoir and there may be several underlying reservoirs under one piece of surface geography, and technically there could be several fields in one area. That is not too common, but it is a distinction.

Q. Now, when are postings made in respect to a new field?

A. Usually when production of the field reaches a quantity of 400 to 500 barrels per day.

Q. Now, you mentioned earlier that these posted field prices are published. Will you explain what you mean by published?

A. Yes. They are printed on a bulletin and the bulletin is distributed very widely, and, secondly, it is posted on the bulletin board at the building of the company who is purchasing the crude. These published bulletins are mailed to the media and any interested parties. Usually the interested parties are the other producers in the field and refining companies who might buy the oil.

Q. So these are available to all potential buyers and sellers?

A. Yes, yes. They are public knowledge and frequently are published by the oil media as a service to the industry.

Q. Earlier in the testimony in this case an exhibit was introduced and admitted into evidence which consists of a paper written by one of the witnesses, Mr. Kaspar, and another man entitled "Auditing Oil Companies," and that exhibit is number 11-11 in this case.

I would like to read you a statement out of that exhibit and then ask for your comments. This begins on Page 1 of the exhibit.

"Although each of the above activities is very different from the others, it may be stated that, in general, the major oil companies do not separate these activities along corporate lines, but rather by departments, each of which is headed by a vice president. In some cases, however, the exploration and producing activities are incorporated separately from the storage, refining and marketing operations. Separation at this point is convenient and practical because of the readily determinable market price of crude oil at the well head; that is at the point where crude oil first reaches the surface of the earth. All crude oil produced in an area has a value equal to the posted field price, which is the announced price currently paid by purchasers at the well head in a specified production area. These posted field prices are circulated by all large buyers and are bona fide competitive prices, not subject to manipulation or rigging and are effectively policed by state regulatory agencies. The posted field price controls what a company receives for its own production sold to others as well as what it pays for production back from others. This is true even where it buys crude oil and resells it to others rather than using it in its own refineries. Crude oil sold at a point elsewhere than at the producing premises is sold at the posted field price plus transportation."

Do you agree with this statement in Mr. Kaspar's paper?

A. Yes, I think it is very well expressed and it is accurate.

Q. And to the best of your knowledge based upon your long experience, this statement accurately reflects the situation in the market?

A. Yes, it does.

Q. And the use of posted field prices?

A. Yes.

Q. Would you explain any other uses of posted field prices?

A. Well, other than as we have said to use them as a price for all purposes, all sales of oil, transfer price between departments as from the Exploration and Production Department into Supply, if all the oil which the Supply Department acquired was acquired on the basis of a posted field price and that price determined the cost of acquisition of all the oil in the Supply, and that cost of acquisition was the basis used in transferring the crude to our own refineries or in pricing the sale of crude to a third party.

Q. Now when Supply acquired the crude was it doing so on behalf of the Refining Department?

A. No, no. Only in certain cases where a special crude was needed by the Refining Department. You say we were doing that, but in many of those cases we were buying the crude from outside.

Q. Now explain the use of posted field prices in determining the amounts due to royalty owners?

A. The posted field price is the price stated for payment to the royalty owners in the contract under which we purchased the oil.

Now rather than name a dollar price, we just said that we would buy the oil based on the posted field price for that field and, of course, those contracts had been in existence for 20 or 30 years. And whatever the posting is, that's the basis that payment has been made to the royalty owners through all those years.

Q. The royalty owners generally accept a price determined by the posted field price?

A. That's correct. They do that.

Q. Is the same true for purchasing oil from working interest?

A. Yes. In fact, the same wording is used. Rather than name a dollar number, you would name the oil, that the oil would be purchased on the basis of the posted field price information for the field in question.

Q. And do the posted field prices determine the selling price when you are selling crude to third parties?

A. Yes, we have sales contracts with the same wording.

Q. And is the same true when you are purchasing crude from third parties?

A. Correct.

Q. Do other companies in the industry use posted field prices?

A. Yes. There are just many, many companies posted. I don't have an idea. Probably 50 or 60 companies issue postings for crude they purchase wherever they may be purchasing.

Q. What percentage of total industry crude production comes from companies who do not have their own refineries?

A. Oh, probably 20 per cent.

Q. And do these companies sell their produced crude at posted field prices?

A. Yes, yes.

Q. And do the companies in the industry that have refineries but no E and P function, purchase their crude at posted field prices?

A. Yes, they do.

Q. Now based upon your experience does the industry accept posted field prices in the measure of the profit derived from the sale of crude at the well head?

A. Yes, they do.

Q. Also based on your experience is this measure of the profit derived just as applicable to crude transferred to Humble's Refining Department?

A. Yes.

Q. During the years in issue did Humble make exceptions to the use of posted field prices on transfers between its E and P function and Refining function?

A. Never.

Q. Never?

A. Never.

Q. No exceptions?

A. No.

(Exhibit Numbers 23 and 24 marked for identification)

Q. I show you what's been marked as Exhibit 23 and ask you to identify what that is.

A. This is a tabulation entitled Crude Oil Posted Prices, named in dollars per barrel. It lists the posting for four grades or qualities of crude. The four are identified in the first line across the top as South Louisiana, North Louisiana, West Texas and East Texas.

These are four typical crudes of which there are large volumes or else they are very important to the industry because of their quality.

Q. From what information was this exhibit prepared?

A. This was prepared from records in our files, the record being the published bulletins of the various companies. And you will note under South Louisiana we have listed postings of four companies, Exxon, Gulf, Texaco and Superior.

And we have in our files their posted prices through the years and we have listed here the price they pay for the crudes named, or, rather, the fields named.

The fields are listed under the company name for Exxon, Grand Isle, Block 16; Gulf, Delta, Ostrica; Texaco, Caillou Island; and, Superior, Bosco. And these are all South Louisiana field with similar-quality crude.

Q. Did you prepare this exhibit?

A. It was prepared under my supervision.

Q. Now why have you included Superior along with the majors Exxon, Gulf and Texaco in the South Louisiana field?

A. Superior is a producing company with no refineries. However, there are locations where Superior has a gathering system primarily for its own crude and they buy other crude in the area, put it in their gathering system and then sell it.

Q. Now you heard the testimony of Mr. Luper on Friday. Is Superior one of the companies that fell into the classification in his Exhibit 22 that showed examples of companies with primarily Exploration and Production operations?

A. Yes, he named Superior.

Q. And in the North Louisiana portion of your exhibit why did you include Placid?

A. Placid Oil Company is another producer who does not have refineries. And the situation is similar. Placid has a gathering system and they buy oil from other producers, move it through their transportation system and then sell it. And these are the prices they pay as a producing company with no refinery.

Q. So they would not be refining any of the product; they would be selling off all of their produced and purchased crude?

A. That's correct.

Q. Do you know whether those two companies settled with their royalty owners at the posted field prices?

A. Yes. Our company has some royalty or fee interest under some Superior properties and they ask their posted price.

Mr. Ragatz: I would like to offer Exhibit 23 at this time.

Mr. Morris: Any objections, Mr. Shapiro?

Mr. Shapiro: No.

Mr. Morris: Hearing no objections, Exhibit 23 is received.

You may proceed.

Mr. Shapiro: I will object to relevancy. I am sorry.

Mr. Morris: You are going to object as to relevancy?

Mr. Shapiro: Yes, sir.

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: It seems to me that one of the principal issues in this case is the integrity of the transfer prices between the E and P function and the Refining function of Humble.

The testimony of both the State's witnesses and Humble's witnesses has been that these transfers occurred and were valid at posted field prices.

This exhibit is intended to be descriptive of examples of posted field prices used to complement the testimony of this witness as to the use of posted field prices by Humble and by other members of the industry. And on that basis we think it is highly relevant and helpful to the resolution of the issues in this case.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: We submit that for franchise and income tax purposes of this state, the net results of the total operations of the company represent the significant base for taxation and not the intra-department transfers or the prices at which those transfers were made. I repeat, it is the total net results of the total operation of the company

under the unitary idea that we consider to be the significant matter in this case.

Mr. Ragatz: Just one further point. The evidence has already disclosed that the net profit of the E and P function of Humble figure internally determined was used by the State of Wisconsin in its calculation of the apportionment formula. And in that the value put on the crude is perhaps the most singly important factor in determining the net profit of the E and P Department, the method by which this value was determined is highly relevant to the outcome of this case. And I would ask that the exhibit be accepted.

Mr. Shapiro: I would like to respond to that, if I may. The net profit of the E and P Department was used for the principal purpose of separating what is situs income under the Wisconsin income and franchise tax law. Specifically, information was requested to make that determination and it was not obtainable. In the absence of specific and direct data from the company's records, it was essential that the functional E and P net profit be used as a base for separating the situs income derived from the income resulting from the sale of crude to outsiders as distinguished from that crude which was not sold to outsiders but which entered the unitary, as we consider to be the refining or unitary process.

Mr. Morris: Gentlemen, Exhibit 23 is received subject to objection of counsel for the respondent.

You may proceed, Mr. Ragatz.

By Mr. Ragatz:

Q. I show you what has been marked as Exhibit 24 and ask you to identify that for the record.

A. This is a tabulation of the Average Industry Crude Price as published by the U. S. Bureau of Mines. It lists prices in dollars per barrel for the total United States and for District V separately for the years 1960 through 1970.

Q. Now would you explain further just what this exhibit shows?

A. The exhibit shows that starting with 1960 the price of crude in the United States was $2.88 rising to $2.91 in 1962, then dropped to a low of $2.86 in 1965 and then started to increase and was $3.18 in 1970. The prices shown for District V followed the same pattern though the range was about 40 cents a barrel less.

Q. Where is District V located?

A. District V is the area west of the Rocky Mountains.

Q. From what information did you prepare this exhibit?

A. This was prepared from information in our files, Bureau of Mines reports which are issued annually.

Q. And was this prepared under your direction?

A. Yes.

Q. The purpose of this exhibit was just to show the average prices during the period in issue?

A. Right, to show that there really was a decline and that prices were generally, though, flat, I would say, during the decade of the 60's.

Mr. Ragatz: I would like to move the admission of this exhibit.

Mr. Shapiro: The same objection to relevancy is made by respondent.

Mr. Morris: The motion to receive Exhibit 24 and the objection by Mr. Shapiro based on similar statements you made on Exhibit 23—Exhibit 24 is received subject to objection of counsel for respondent.

Mr. Ragatz: No further questions.

Mr. Morris: At this time we will take a ten-minute break.

(Recess)

Mr. Morris: You may proceed with cross-examination, Mr. Shapiro.

Examination

By Mr. Shapiro:

Q. Mr. Jeager, during the years 1965 through 1968 your position was with the Supply Department?

A. Yes.

Q. And that was a corporate staff department, is that correct?

A. Yes.

Q. And is that the department that coordinates the supply of crude oil to the Humble refineries?

A. Correct.

Q. Mr. Jeager, would you distinguish between sales of crude at the lease and sales of crude by the Supply Department? How are they different?

A. I guess they are really not any different with respect to the, oh, price, and the fact that crude is going to another company. There is a slight difference in the kind of contract we use, but that usually has to do with the term of the contract. At the lease the oil is delivered directly to another company's pipeline, it gathers the oil and moves it on, but at the lease the mechanism was that the Supply Department bought the oil from the Producing Department, or it was transferred to Supply and then the Supply Department signed a contract with the purchasing company. Now that procedure takes place at the lease everywhere, regardless of what is the ultimate disposition of the crude, even if the crude is being gathered by an Exxon pipeline or a pipeline company who is going to deliver it to us. Now if Exxon is going to keep the crude and it goes into an Exxon pipeline system, then after the transfer from the Production Department to Supply, the crude is just tendered to the pipeline. If the pipeline is operated

by another company, then the Production Department transfers the oil to the Supply Department and Supply makes a contract with the third party who buys the oil, and it is delivered into the pipeline—into their pipeline.

Now there is another category of sale which would occur where we have a delivery point from our pipeline system to another company's pipeline system or to another company's refinery, and we have all of these things—

Q. Yes.

A. —Where we would say sell to another company's refinery, we would have the contract which would provide for a certain amount and certain quality of crude, and by now you have a mixture of crudes in the system, and the pricing basis would be the cost of acquisition of the crude plus applicable transportation, and that is published tariffs of the pipeline, and the usual terms of time and quantities and so forth.

Q. To what extent are the transactions by the Supply Department made under exchange agreement?

A. These are all by sales, no exchanges. For this kind, this domestic—the movement of domestic crude was all by selling.

Q. That was not under exchange agreement? Was cash received for a sale of the crude?

A. Right.

Q. From the buying company?

A. From the buyer, that's right.

Q. To what extent are sales of crude oil at the lease made pursuant to exchange agreement?

A. There are none.

Q. You mean when a sale was made, cash was received from the buying company?

A. Right.

Q. And did Humble have any arrangement whereby product was to be obtained from the buying company of equivalent value?

A. No. You mean—do you mean crude, equivalent value of crude to get product back—

Q. Yes, yes, yes.

A. No, not in these years.

Q. Not in the years 1965 through 1968?

A. No.

Q. Were there trades or exchanges of crude oil made by Humble during these years?

A. The only thing you could call an exchange would involve acquisition of import rights, wherein we would acquire the right to import crude from a refiner who had, you know, earned the right from the government under the import program, and the government relations would not permit sale of those rights, and so there was an exchange arrangement worked out by the oil import administration, which involved domestic crude and foreign crude, but those exchanges, so-called, were always an exchange of domestic crude for foreign crude and would be made at the refinery, not in the field.

Q Isn't it true that a departmental—that no departmental profit or loss generally was recorded by the Supply Department?

A. The Supply Department was not a profit center, if that is what you mean.

Q. Yes.

A. No, it was an administrative, and the costs were all spread out.

Q. How did that come about? You stated if there is a sale of quantity of crude for cash, how did it come about that no profit was recorded if the selling price—if no profit was recorded?

A. I stated that the sale price would be the cost of acquisition plus transportation, so if you sell it for what you pay for it, there is no profits.

Q. So that the profit would have been taken by the E and P Department on the transfer to the Supply Department, is that correct?

A. Well, if there was one. I don't know about that, but the price we paid was the market price. Now if they produced it for less than that, I guess they made a profit.

Q. Let us suppose that in a year that is within the period in issue, Humble produced 200 million barrels, and just—200 million barrels of crude and that 75 million were sold at the lease, and if you could keep these numbers in mind it would make it easier, which left 125 million barrels transferred to the Supply Department; now at that point is it your testimony that of the 75 million barrels sold at the lease, all of those sales were for cash?

A. Well, yes, but let me correct it a minute, though. As far as the whole 200 million barrels, they would have been transferred to the Supply Department, everything produced is transferred to Supply, and then Supply is responsible for disposing of that.

If we sold it to a third party, it was under a contract and we received money for it.

Q. You received money for it and there was no arrangement whereby you were to acquire from that—from that other company, amounts of crude?

A. Well, there was no related arrangement. We bought a lot of crude and a lot we bought from companies we sold to, but those were not—they were separate arrangements for different reasons.

Q. Was there any overriding arrangement at all or contractual arrangement of any kind for buying and selling as between your company and another major oil company?

A. Definitely not.

Q. To carry the supposition one step further, if in that example 300 million barrels were purchased by Humble, is it your testimony that all of these 300 million barrels were purchased for cash?

A. That's correct.

Q. And one step further, if 125 million barrels were sold by Supply, or a total of 200 million, that is 75 that we referred to and another 125, all these sales of crude would have been for cash?

A. All crude sold to third parties was for cash.

Q. But I would like to confine the question to total company sales and acquisition of crude.

A. Well, all right; a total supply of crude was made up of the produced crude and purchases, and I am excluding imports because we are talking domestic. That all went into a pot or one big supply package from which then we sold crude to third parties and transferred crude to our refinery.

The crude that went in was categorized only by quality and in some cases location, and it had—the only identity location was cost of acquisition which we kept a careful track of, but the total package of crude, each quality or grade that we had we knew what we paid for it and that is the price we used when we sold it, whether it was sold to a third party or whether it was transferred to our Refining Department.

(Exhibit Number 25 marked for identification)

Q. Mr. Jeager, I show you what has been marked as Exhibit 25 and are you able to identify what this exhibit is?

A. Index of Crude Oil and Product Exchange Agreement.

Q. Yes, sir. Now, with particular reference to Page 3, subheading 3, at the bottom of the page is entitled "Exchange of Crude Oils," and it reads in part, "To the

extent of the volumes hereinafter specified, Pure and Humble shall exchange crude oils, by means of Pure delivering crude oils to Humble at Bayway, and Humble delivering crude oils to Pure at Lemont or in the field if required."

Now, with reference to that statement could you explain how that transaction came about and what relation it has to transactions in crude?

A. This is a special arrangement that has been in existence for quite some time between Humble and Pure Oil Company in Chicago. It was a method that Humble used for, if you will, transferring or supplying its products in this particular area.

Now, in effect from time to time there was some crude delivered to Pure, and Pure would deliver to Bayway, but also the products' offtake from Pure in Lemont was measured by product offtake from Pure.

When I answered you a while ago I was thinking in terms of net products to the extent that we did not have any arrangement where we put crude into another company's refinery just to get products. This was really a combination of a crude exchange and a product exchange offsetting.

Q. Was the Supply Department responsible for the negotiations of a contract such as that?

A. Yes, the Supply Department participated in this. This really was done before I got in the Supply Department. As I recall, the Refining Department had a major responsibility on it.

Q. Then if we go back—I would like to clarify that point. If we go back to our supposition that in any one of the years involved here a total of 200 million barrels of crude were produced by Humble, and I believe you testified that 200 million barrels would be transferred to Supply, to the Supply Department?

A. That's right.

Q. Now, if a quantity of that crude oil was disposed of by the Supply Department—I'll rephrase that question.

To what extent would the disposition of crude by the Supply Department be made under any exchange agreement posed in terms of percentage or otherwise?

A. Again I say we had no crude exchanges. I guess in our operation consideration of this agreement was a special one that was something that was a continuing arrangement. Actually the crude that would be involved in this was acquired on a price basis. If in fact Pure delivered crude at Bayway, there was a price established.

Q. But that is an exchange agreement, is it not?

A. Yes, in a sense.

Q. Well, it is entitled as such?

A. The title is "Exchange," that's right.

Q. And my question to you was to what extent acquisitions and dispositions of crude were made by the Supply Department of Humble under similar arrangements?

A. Well, there weren't any others.

Q. You mean that's an exception?

A. As I said a while ago, this is a special situation, and actually it was unique. There weren't any others.

There were, I guess—there is good reason for crude being—not being exchanged actually because of the pricing system and the fact that every crude transaction, many crude transactions involve other people, particularly at the lease.

Q. To what extent did Humble have its crude oil refined by other companies?

A. During these years Humble had surplus refining capacity. We refined all of our products. We had no arrangements which affect leasing in the refining capacity.

Q. I take it in other years the situation was different, is that right?

A. I don't recall any. We have had a surplus of refining capacity as long as I have been in Supply.

Q. Might there have been other arrangements similar to the exchange agreement that you have before you that you are not aware of?

A. No, there couldn't be any I wouldn't know about. I mean, there could have been some in the 50's that I wouldn't know about, but there have been none since 1960.

Q. Well, now, isn't it true that Humble acquired crude over and above what it produced in order to supply the refineries?

A. That's true.

Mr. Shapiro: I will move the admission into evidence of Exhibit number 25.

Mr. Morris: Any objection, Mr. Ragatz?

Mr. Ragatz: No objection.

Mr. Morris: Exhibit 25 is received in evidence.

Mr. Shapiro, do you have any more cross?

Mr. Shapiro: Yes, sir.

Mr. Morris: You may continue.

By Mr. Shapiro:

Q. Mr. Jeager, is it true that changes in the general level of the posted field prices are normally led by integrated oil companies such as Exxon and Texaco, Phillips?

A. Oh, sometimes. No, I guess, let's talk about time. I will have to—what period of time are you talking about?

Q. Well, primarily the period in issue.

A. In issue?

Q. Yes, sir.

A. Yeah. I guess particularly during this time there were changes instituted by the smaller producers or by the producers only as indicated on this Exhibit 23 where Placid exchanged to Cotton Valley in August of 1967 and it was a year later before Exxon changed their Cotton Valley posting.

Q. In that first column, Mr. Jeager, of Exhibit 23 under Exxon, does the $3.30, those dashes underneath the 3.30 are they intended to mean no price?

A. That price stood for that whole time.

Q. That price stood?

A. That's right. Now what I quoted, if you will notice the column under North Louisiana Placid, Cotton Valley, where Placid raised their price from $2.95 to $3.02 on the 8th of August, 1967, and the 8th of August, 1968, Exxon went from $2.95 to $3.00, which was two months after Placid had gone to $3.12.

Now that's an indicator of what has happened in the last six or seven years. The price changes in crude has been initiated by the smaller companies, many of them in Oklahoma and Kansas where small refining companies are struggling for crude and they have initiated price changes. I guess that answers your question.

Q. Humble's crude oil production was between 60 and 70 percent of its refining capacities during these years, is that correct?

A. Oh, I guess. The records—I haven't reviewed those numbers lately. That sounds right.

Q. Why didn't the refineries operate at full capacity, Mr. Jeager?

A. Well, there were two things that happened there during this period of time. But speaking to Humble, I forget, 1961 or 1962, we lost a big customer, Standard of Kentucky, who was acquired by Standard of California. And it was a four-year phaseout of a very large customer. It was all we could do to—in fact, one year our refinery run less than the previous year during that period. However, working as hard as we did, we put a level out, the below period.

Now during that same period of time all of the industry had surplus refining capacity. Just a matter of over building in the competitive industry.

Q. Did that result from the fact that there was no market for produced crude rather than a shortage of crude or produced gasoline—did it result from the fact that there was no market for finished product rather than a shortage of crude?

A. That's correct. There was ample crude supply.

Q. So the fact that there was a shortage in the Marketing Department resulted in that under refined, under capacity for refineries?

A. I am not sure I follow you.

Q. Can you tell the Commission what the reason was for refineries not operating at full capacity?

A. The reason the Humble refineries weren't operating at full capacity was because we had lost a big customer. We had built refineries expecting a certain growth every year, expecting to participate in the normal growth of the product market or of total demand. And then all of a sudden, without warning, a large customer was taken away. Hence, the growth that we had anticipated we were not able to realize. We actually did grow in other markets, but the growth there just about offset the loss of one big customer so that our refineries' runs were level for a number of years.

I don't really know what you mean by a shortage of market except there were so many refining companies and so much crude oil to be refined that there was, the market was supplied in a competitive situation by all of the companies. And I can't answer why they over-built, but generally there was more capacity than was needed to supply the market of the 60's.

Q. During this period a very modern and complex refinery was being constructed at Benicia, California, was it not, sir?

A. Yes, it was built during the 60's.

Q. Wasn't that supposed to go on stream about the latter part of '68 or the first part of '69?

A. Yes, it was.

Q. Now then, can we explain the fact that there may have been problems in not reaching full capacity for refining and yet a huge, new refinery at Benicia was being constructed?

A. We have got to talk about time a little bit. I think one thing about your questions, you don't specify times and we are talking here—I have been discussing the period of the 60's.

Q. Yes.

A. And not to be an economist, but I know how we look at supply problems and we were looking at growth rates. In the beginning of the 60's we had a growth rate prediction, whatever it was, and planned to meet that. And then about '61 we lost a customer. So our growth rate was flat, though we had anticipated growth; and our Refining Department was just overbuilt for a while. But as you proceed through the 60's, then you begin to catch up. And you are talking about 1969. Well, by then you have ten years of growth and you need a capacity.

Q. In the early 60's wasn't the decision made by Exxon or Humble that more and more crude should be explored for and found and produced to meet possible expected future demands?

A. Yes.

Q. You mentioned that about 20 percent of the domestic crude oil is produced by independents, is that correct, sir?

A. That's a rough number.

Q. Yes. Isn't it also true that about 85 percent of the refineries are operated by integrated oil companies?

A. Oh, I thought 85 might be a little high, but you probably got some data I don't have in mind. That's again published data.

Q. Does that seem reasonable, sir?

A. That's about reasonable.

Q. And those integrated companies produced a major part of their own crude oil?

A. Yes.

Q. Is it true that the 20 largest integrated companies or crude oil production have around three-quarters of their refining capacity?

Mr. Ragatz: I would like to interpose an objection at the moment to the continued use of the phrase "integrated oil companies" unless counsel wants to define what he means. It seems to me that's subject to varying descriptions that could be provided by an economist and not necessarily this witness.

Mr. Shapiro: Mr. Luper, gentlemen, defined what I believe many of us considered to be a rather common useage, common-used term "integrated oil company" or "integrated petrolem company" to mean that the three major functions of Exploration and Production, Refining and Marketing are carried on by that type of company.

Is that your understanding of "integrated oil company", sir?

The Witness: Oh, I heard his testimony, yeah. I still don't claim to be able to describe or define an integrated oil company.

Mr. Morris: We will be off the record for a minute.

(Discussion off the record.)

Mr. Morris: You understand Mr. Shapiro's question, the original question that was asked?

Mr .Shapiro, would you repeat the question, your original question, or do you wish it read back?

Mr. Shapiro: I would like it read back.

(Question read.)

Mr. Morris: Do you understand the question?

The Witness: No, I don't really.

Mr. Ragatz: Mr. Commissioner, I would like to pose another objection. I think the inquiry now has strayed pretty far afield. I don't see the relevance of that line of inquiry to the operation of Humble Oil and Refining in relation to the issues here, so I would also interpose an objection on the basis of relevancy.

Mr. Morris: Mr. Shapiro.

Mr. Shapiro: The witness testified as to a percentage of the domestic crude oil that was produced by independents. Now he is referring to a segment of the industry, and that is what we are also inquiring about in our question.

Mr. Morris: I will allow Mr. Shapiro to continue the line of questioning subject to objection of counsel for the petitioner, but again getting back to the original question I think it was the 20 integrated oil producers is what was suggested. You heard the reporter read back the question, and do you understand the question?

The Witness: I don't understand the part—

Mr. Shapiro: I am not sure it came out right on the read-back.

Mr. Morris: Would you repeat your question?

Mr. Shapiro: Yes, sir.

By Mr. Shapiro:

Q. Do the 20 largest integrated oil companies have crude oil production of around three-quarters of their refining capacity?

A. You mean domestic crude oil production?

Q. Yes, sir.

A. I don't have the data, but I doubt it.

Q. You doubt it?

A. Yes.

Q. What would your response be in terms of a percentage?

A. The company is importing about a third of their requirements now.

Q. I didn't hear you.

A. They are importing about one-third of their requirements.

Q. I am referring to the years in issue.

A. Well, in those days imports were about 12 per cent of the national requirements, but the major companies were running all of the imported oil, so I just don't know whether 75 is a good number or not.

Q. Wasn't it Humble's objective during this period that we are concerned with to increase oil production by —say between 1960 and 1970 by 50 per cent and to narrow the gap between its production and refinery capacity?

A. Oh, I don't recall any such objective.

Q. Might that have been an objective that you are not aware of?

A. Well, the thing you are talking about might have been some statement or something. Basically it certainly was an aggressive company in the production business; they are always trying to increase their production. It is—it could have been an objective. I just don't recall any such statement.

Q. Now if they are trying to increase their production, it is necessary to have refining and marketing facilities to carry out the disposition of that production, isn't that true?

A. No.

Q. How else is crude oil disposed of unless it is converted by refinery and sold on the market?

A. Well, you have about 10,000 independent producers that have no market—well, you have 125 refining companies—you have probably 25 to 50 refining companies that have no production in the United States.

Q. But isn't it true that the large integrated oil companies, of which Humble was one of the largest, accounted for the major production of crude oil in the United States?

A. I don't know what you mean by "major," but you make it sound awfully big.

Q. Isn't it awfully big?

A. Sir, it is big, yes.

Q. I have no further questions at this time.

Mr. Morris: Redirect.

Examination

By Mr. Ragatz:

Q. Mr. Jeager, you were asked on cross-examination about whether the so-called integrated oil companies led in changing the postings. Would you comment on whether or not during the years in issue Humble was a leader in changing posted field prices?

A. Humble was not a leader during those years.

Q. No further questions.

Mr. Morris: Mr. Shapiro.

Mr. Shapiro: No further questions.

Mr. Morris: Any reason for this witness to be held over for any further testimony?

Mr. Ragatz: Not on our—

Mr. Shapiro: No.

Mr. Morris: Therefore this witness is excused and this hearing is adjourned to 1:30 this afternoon, and we will reconvene in this courtroom.

(Noon recess, 12:00-1:30 p.m.)

AFTERNOON SESSION

Mr. Timken: Are we ready to proceed, Gentlemen?

Mr. Ragatz?

Mr. Ragatz: Yes.

Mr. Timken: Mr. Shapiro?

Mr. Shapiro: Yes, sir.

Mr. Timken: Mr. Ragatz, I believe you are ready to call another witness.

Mr. Ragatz: The petitioner calls John Carter.

JOHN CARTER, called as a witness, having been first duly sworn, under oath, testified as follows:

Examination

By Mr. Ragatz:

Q. Will you state your full name for the record.

A. John J. Carter.

Q. Where do you live, Mr. Carter?

A. I reside at 5213 Valerie Street, Bellaire, Texas.

Q. How old are you?

A. Sixty-five.

Q. Would you review your educational background for us, please?

A. I graduated from Bowling Green College of Commerce in 1932 with a B. A. in Commerce, and immediately following graduation from college I worked about 10 months at a small cooperative training as an accountant, and then went to Houston to teach business law and accounting in a business school, and I was there for about 10 months, and then in 1934 I went to work for Humble Oil and Refining Company.

Q. What professional socities do you belong to?

A. I belong to the Natural Gas Men of Houston. I have an individual membership in the American Gas Association. I was on the Board of Directors of the Inde-

pendent Natural Gas Association of America for the last two years of the time when I was with Humble.

Q. Have you had any government services?

A. Oh, I overlooked—I haven't had any government service, but for about six years prior to the time that I retired from Humble I was the Secretary of Interior Emergency Adversary Committee for Natural Gas, and I have worked before the Federal Power Commission on cases that we had before the Federal Power Commission.

Q. Presently are you retired?

A. I am retired, yes, sir.

Q. What was your occupation before you retired?

A. Immediately before I retired I was a senior advisor to the General Manager of the Natural Gas Department, but that was from August 1st, 1972 until my retirement on November 1st, '73, but prior to that I was the General Manager of Humble's Natural Gas Department, and I stepped down in 1972 in anticipation of normal retirement on November 1st, 1973.

Q. What other positions have you held prior to being Manager of the Natural Gas Department?

A. Well, all my experience with Humble was in natural gas. I started work in the Natural Gas Department in 1934 as a clerk in the Gas Department and came up through various occupations in the Gas Department to finally Manager of the Gas Department and General Manager of the Natural Gas Department.

Q. How many years of experience did you have in the oil and gas industry?

A. I had 39½ years of experience with Humble and 10 months with another cooperative refinery, so nearly 41 years.

Q. In your position as General Manager would you describe your duties and responsibilities?

A. Well, as General Manager of the Natural Gas Department my responsibility was management of the sale and purchase of gas for the Humble Company, for the Production Department.

Q. Where did the Natural Gas Department fit into Humble's organization structure?

A. We are the Headquarters's Department, but our prime function is to sell gas for the exploration and production function and to purchase such gas as they might purchase so we were in effect a service organization to the Production Department.

Q. Was the Natural Gas Department accounted for as part of the exploration and production function?

A. All of our expenses were rotated to that function, yes.

Q. Now, was the Natural Gas Department a separate profit center?

A. No.

Q. A separate investment center?

A. No, sir.

Q. On what function's books were carried all the plant and physical equipment of the Natural Gas Department?

A. You mean all the producing facilities of the company and plants?

Q. Correct.

A. That was all the Production Department's books.

Q. Did this include the gas plant?

A. Yes, sir.

Q. Were the gas plants another step in a separation process of the raw gas?

A. Yes, and the plant was a part of the producing operation.

Q. To your knowledge did any of the natural gas go to the Refinery Department for product conversion?

A. For product conversion?

Q. Correct.

A. None for product conversion, no.

Q. Did any go for fuel consumption for the Refining Department?

A. There was gas that went to the Refining Department for fuel and heat.

Q. Of the total natural gas, what percentage would you say went for fuel consumption by the Refining Department?

A. In the period that we are talking about here, a little over 4 per cent.

Q. What was the primary function of the Natural Gas Department?

A. To sell gas was the primary function. Of course, we had a lot of other dealings that were related to that, but our prime function was to sell gas.

Q. Did you purchase any gas, too?

A. Yes, sir.

Q. What did Humble do with the gas it produced?

A. Consumed it in that operation, and sold it.

Q. Where was this gas sold off?

A. Well, all the gas that we sold was sold in the state in which it was produced. It was sold in the field at the individual well or it was sold in a central point in the field or it was sold at the discharge of the gaseline plant or on the Texas Coast. We had a small industrial gas system that we serve industry along the Texas Gulf Coast and some was sold to industry through the industrial system.

Q. How much of what was sold was purchased gas?

A. Oh, a very small percentage, 3 per cent, something like that. Most of it was our own gas that was sold.

Q. And because of the purchased gas, was Humble a net seller of gas?

A. We definitely were a net seller of gas, yes.

Q. What functional department got credit for the income from these gas sales?

A. The Production Department.

Q. I would like you to refer to Exhibit 20 which was introduced and identified during the testimony of Mr. Luper. I'm sorry, it is Exhibit 21.

Can you point out on that exhibit where the producing areas are for natural gas in this country?

A. All of the states with the diagonal lines drawn across them are states in which we had gas production at that time.

Q. And which were the states where your principal gas production was?

A. The principal gas production, Texas, Louisiana and Mississippi, Oklahoma and New Mexico.

Q. And where were the sales made of the gas produced in each of the states?

A. All gas that we sold was sold in the state where it was produced.

Q. In each case?

A. In each case, yes.

Q. What activities did the Natural Gas Department have in the State of Wisconsin, if any?

A. We didn't have any.

Q. There were no production activities?

A. No.

Q. And no sales activities?

A. No, sir.

Q. And no purchase activities?

A. No.

Q. And no utilization of gas for any purpose internally?

A. No, sir.

Q. How was the selling price of the gas determined on sales to third parties?

A. Negotiated, it was negotiated prices.

Q. And how was the purchase price determined when you were buying gas from third parties?

A. On the same basis. Gas contracts are negotiated on a negotiated basis, both purchase and sale.

Q. How was the gas valued for purposes of Humble's internal deliveries?

A. Still on third party contracts. In our job in the Natural Gas Department one of the things that we had to do was to keep up with the market situation so we attempted to keep abreast of the market situation and our transfer prices were determined by use of third party contracts that we could obtain information on, so we could keep current and in line with the going prices in the areas that we were talking about.

Q. What were some of the characteristics of the negotiated third party contracts?

A. Well, most of your gas contracts are long-term contracts. They usually are 20 years. Many contracts—we didn't write many, but many contracts were even for the life of the lease where gas might be found, but generally they were all long-term contracts, more normally 20 years.

Q. How was the price set in these contracts?

A. The price was established by negotiations.

Q. Were there escalators or adjustments to the price?

A. The contracts usually provided for fixed step escalation; some for price redetermination. Everybody was trying to negotiate the best deal. The seller was trying to get the best deal and the buyer was trying to do the same thing so it was a matter of straight negotiations.

Q. What did the contract generally say as to quantity?

A. It specified the quantity as to how the gas was to be taken, and, of course, the producer and seller wanted the quantity to be as large as possible, and the buyer had to be careful and not overburden themselves with gas he couldn't use, so when you started negotiating a gas con-

tract price, that was just one of the things that was negotiated. The term was also negotiated, the quantity, the quality, who was going to pay the taxes. All these kinds of things were just part of the negotiations that were carried on.

Q. Now, with whom would Humble normally be contracted, what kind of customers?

A. Principally intrastate pipelines; that is pipelines that move gas across state borders; that is pipelines that purchase gas in the state and sell it in that same state; and then we serve industrial customers along the Texas Gulf Coast. We were serving them with Texas gas, and that is the three principal types of contracts that we made, big contracts.

Of course, we made contracts with other producers where we would buy some gas from another producer where it was going into the gas plant, but these three are the principal types of contracts that we made.

Q. Now, how did the delivery points of gas affect the prices?

A. Again, delivery points or the delivery point is negotiated under the contract, but if there was extensive delivering involved, the producer could usually get a better price for the gas by taking it to a central point, but the better price he got was just about enough to offset the transportation, the transportation costs that he had to incur at the central point; so the difference between the central point delivery and the well head delivery would be the transportation costs.

Q. In addition to these negotiated third-party contracts, what other sources of competitive price information were available to you?

A. Well, in Texas where our most extensive operations were, all of the purchasers of the natural gas have to file a report with the State Comptroller; and once these reports are filed with the State Comptroller, they are public information. And on these reports it shows the volume of gas that the purchaser is buying, who he is buying it from and the amount of money that he paid for the purchaser and where the gas was located. So we could get these purchaser's reports from the State Comptroller and we get a pretty good fix on the price of gas in the various areas.

In addition, a considerable portion of gas in Texas moves in interstate commerce, or Louisiana too moves in interstate commerce. And all contracts where gas moves in interstate commerce has to be filed with the Federal Power Commission in Washington. These contracts are public information once they are filed with the Federal Power Commission. So we could get price data from those. And then it was our responsibility in the Natural Gas Departments to try to keep up with markets. So our men that were mixing around in the industry tried to get the best information that they could get, too, on what the markets were.

Q. What kind of information could you obtain from the information on file with the Federal Power Commission?

A. The contract itself was filed with the Federal Power Commission and it would show what the practice was, what the volume was, where the gas was located, who was the seller and who was the buyer and the quantity had to be taken, what the quality of the gas had to be, and all of those kind of things was entered into the contract. And it was just part of the contract.

Q. Now in what situations did you need to determine internal transfer prices within Humble?

A. Well, for gas going into our industrial gas system we needed transfer prices there because the gas was transported from the lease through their system to the industrial consumers on fixed contracts. But in order to settle

with the royalty owners and settle with the production taxes with the State of Texas, we had to set a fair price on the gas that was going into the system; so we needed it for that.

The Production Department in its field operations used considerable amount of gas for field operations for heater treaters, operating compressors and such things as that. And we still had to value that gas for those purposes. And we had to establish prices for the gas that goes to the Refining Department although the way we established price going to the Refining Department is the transfer of price to the Production Department to the Refining Department was to use in most of this period that we are talking about now, we were selling gas to another refinery, a large quantity of gas to another refinery for the same purpose that Exxon was using the gas for. So our refinery was charged the same price that the other purchaser was charged.

Q. Maybe you have already answered this but I am going to ask you anyway how the internal transfer prices were generally determined for any refinery?

A. Well, that's what I said, I believe. They were set all in relation—The information that we got from the Comptrollers Department were all third-party contracts. Third-party contract data. Those prices and everything were right there from third-party contracts and, of course, what we were primarily interested in the transfer price was the pricing, but we could tell about the volume too because the volume showed up in that report.

Q. Now were these the same prices at which, when you purchased gas, you were purchasing it at?

A. Yes. Our prices had to be competitive if we bought any gas.

Q. Now was the portion of the gas income of Humble's E and P Department from internal transfers derived by use of these field prices?

A. Yes, sir. That's where the production for that part that was consumed within the company, that's where the Production Department's income was derived from. Those prices were used in arriving at the income for that gas.

Q. And you commonly refer to those prices as field prices?

A. Field prices and the transfer of price to the refinery. The field price is the well price, the well head price. The other transfer price was the one to the refinery which didn't relate to the field.

Q. But it was determined the same way?

A. It was what?

Q. Determined in the same way?

A. It was determined by a third-party contract.

Q. So then the prices of the gas on sales to third parties were based upon actual contracts negotiated with the third parties?

A. They were based on actual contracts that had been negotiated by someone with third parties.

Q. And the transfers internally by Humble were based upon the same criteria, the same contracts?

A. Well, in the period that we are talking about here, they were based on contracts that we had negotiated with third parties there, one with the refinery that you mentioned. And when that contract terminated, then we switched over to another contract of similar quantity and just about the same related price. So they were still tied into a third-party contract.

Mr. Ragatz: No further questions.

Mr. Timken: You may cross-examine.

Examination

By Mr. Shapiro:

Q. Mr. Carter, do you get, I should say, does the company get crude oil and natural gas from the same wells?

A. Yes, sir. Let me qualify that. That is one source.

There are some that you don't get both, but we do get crude oil and natural gas from the same well.

Q. Will you please describe for the Commission each of the steps involved in bringing the natural gas out of the ground up until the time it is delivered to the purchaser?

A. Well, it would be a layman's description. Now I am not a technician so I can't go into all the technicalities of it. But using the type of gas that you are talking about where there is oil and gas that is produced from the same well, as the oil and gas comes out of the well, it goes into a separator. The separator lets the gas go off the top and goes into the pipeline and the oil comes out of the bottom and is separated and goes to the lease tank.

Now that's just simple but, as I said, I can't go through all of the technicalities of it because I am not a technical man.

Q. And that's with reference to the gas coming out of the same wells as the crude?

A. Yes.

Q. And what is the other?

A. If it would come out of the gas well, it would be a similar operation, except in the first one that you are talking about is primarily oil and gas is secondary. If you get over into a gas well, it would be primarily gas with the condensite being secondary.

Q. What is the function of a gas plant?

A. It's to extract additional liquids out of the natural gas.

Q. And how close to the well or wells is the gas plant located?

A. Well, that would vary. Some of them are in the field, some of them—You can't say any definite thing because there is hundreds and hundreds of plants and they are, all of the wells, in different locations. Generally it's close to the field where you process the gas.

Q. And what is done with the liquid extracted from the natural gas?

A. Well, I can't be specific as to that with the liquids that are extracted. It all depends. Certain plants extract different degrees of liquid. Some of them extract only the natural gasoline, others going to natural gasoline, butane, propane and some of them go on up and get methane and liquified ethane out of the gas. So the disposition of it, each plant just—they disposce of whatever their production was. But it goes into the market place.

Q. And how do they liquify it? Can you answer that?

A. No. I think you are getting out of my range now.

Q. These derived products that you referred to are used or sold or could you explain that a little more?

A. Yes, sir. They are useable products. When they are extracted, they are extracted for the purpose of getting into the market place.

Mr. Shapiro: Can we have five minutes?

Mr. Timken: Surely. We will take five minutes.

(Recess 2:00 p.m.)

Mr. Timken: Back on the record.

Mr. Shapiro?

Examination

By Mr. Shapiro:

Q. Mr. Carter, are these liquefied products that are derived from the natural gas transferred to the Marketing Department for sale?

A. You know, I don't know whether I can answer that in the period we are talking about here. The Production Department handled the plant's products for the early period of the time, and it was a change that took place in there and I just can't answer when it did take place.

Q. But somehow they got into a marketing channel for sale?

A. Some of them may have, but I am just—I didn't have anything to do with it, so I don't—

Q. From your general understanding, if they weren't destined for sale, what was done with the liquefied products?

A. Well, I know the Production Department—they liquefied ethane, they liquefied ethane and before they could go after ethane they would have a market for it to some chemical company.

Q. So it was sold?

A. It was sold, it was utilized, yes, sir.

Q. I have no further questions at this time.

A. Yes, it was sold.

Mr. Timken: Any redirect, Mr. Ragatz?

Examination

By Mr. Ragatz:

Q. On that same point, Mr. Carter, was it the Production Department that made the sale in those situations?

A. In the early days they did. More recently I can't —that is what I say, I can't give you an answer on that.

Q. But the pattern has been that the Production Department itself would make the sales of these gas plant products?

A. Yes.

Q. You were asked about the function of the gas plant; is it or is it not a further separation of the natural gas on a more sophisticated level, but analagous to what goes on in the original separator at the well head that separates the oil from the gas?

A. It is similar to it, but it is more elaborate.

Q. Now, one other question: of the total produced and purchased gas by Humble, how much of it was sold to third parties?

A. Well, I don't know that I could give you an exact percentage, but of course gas is something you don't store. When you produce it, it has got to go right into the market there. I say you don't store—you can store it, but there wouldn't be any point to a producer producing it and

putting it back in storage. When he produces it, he wants to market it, so we marketed all of the gas we didn't use in our own operation, so I would say it was 88 per cent of it, or something like that, with the other 12 per cent—8 per cent of it being used by the Production Department and 4 per cent being used by the Refining Department.

Q. No further questions.

Mr. Timken: Any re-cross?

Mr. Shapiro: No, sir.

Mr. Timken: Mr. Carter, you are excused. Thank you.

(Witness excused)

Mr. Timken: You may call your next witness.

Mr. Ragatz: The petitioner calls Donald A. Campbell.

DONALD A. CAMPBELL, called as a witness, having been first duly sworn under oath, testified as follows:

Examination

By Mr. Ragatz:

Q. State your full name for the record.

A. Donald Arthur Campbell.

Q. Where do you live?

A. Houston, Texas.

Q. How old are you?

A. Forty-five.

Q. Would you review your educational background, please?

A. I have a Bachelor of Chemical Engineering Degree from Georgia Tech.

Q. What is your present occupation?

A. I am a staff Commerce Advisor in the Supply Department.

Q. Of what company?

A. Exxon.

Q. How long have you been with Exxon and its predecessor?

A. Twenty-three years.

Q. Would you briefly review the history of your employment as to the various positions you held during that time?

A. Yes. When I left school I went to work in a refinery in Baltimore and I was there for approximately six years, and I transferred to the Marketing Department and I was in Marketing for 10 years, and the last seven years I have been in the Supply Department.

Q. How many total years of experience do you have in the oil and gas industry?

A. Twenty-three.

Q. What are your duties and responsibilities in your present job?

A. In my present job I have the responsibility east of the Rocky Mountains for the exchange of products, whether they are finished products or intermediate streams in the refinery, the setting up of exchanges, whether they are for a long term or spot arrangements to cover emergencies, and I also buy product when we need product, and I sell when we have surpluses.

Q. Are you familiar with the publications called "Platt's Oil Gram" and "Platt's Oil Price Handbook"?

A. Yes, sir.

Q. Would you describe them, please?

A. Well, Platt's Oil Gram is a two-section news service put out by McGraw Hill that has a news service covering the items of interest in the news as they relate to the petroleum industry, whether they be domestic or foreign, they cover such items as Congressional activities, various pronouncements by oil companies on expansion projects and that type of nature, and the news service repeats certain items of news, I mean the price service covers certain items of news, but primarily reports on the market prices of various products at various points in the United States.

Q. Now this is the Oil Gram, I take it?

A. Right.

Q. What is the Platt's Oil Price Handbook?

A. The Platt's Oil Price Handbook is a yearly summary of the daily reports.

Q. Is that published in book form?

A. Yes, sir.

Q. Now just what prices are reported in these publications?

A. The publication reports prices on all types of products and they report at various locations, depending upon the normal type of sales that are made at that point, at the refineries, and at the ocean terminals they report prices related to ship cargoes or barges or pipelines, and at the various rack locations at the inland terminals, they report the prices of products in the truck.

Q. These refinery prices and rack prices, is that what you commonly think of as the wholesale price level for products?

A. Yes.

Q. How many products are covered by the reporting services?

A. There must be 45 or 50. I have never counted them.

Q. How are the prices determined that are reported by Platt's?

A. In most of your rack prices in your land terminals, your price is a price that is posted by the companies that were selling at that point. On your Gulf Coast cargo price, it is almost an editorial-type price today. At one time the companies did post what price they would sell a cargo of gasoline, but today the editorial staff through their various news sources finds out at what prices various products are being sold.

Q. Are these prices between unrelated buyers and sellers?

A. Yes.

Q. Are they prices at which products are actually changing hands?

A. To the best that they can report, they state that they do not change these prices unless they have evidence that product has moved at those prices.

Q. How long has Platt's been publishing these publications?

A. They have been in business since 1934, I think.

Q. And how frequently are they published?

A. Every working day.

Q. Is that the Oil Gram?

A. That is the Oil Gram and the news service.

Q. How frequently did you say the Handbook was published?

A. Once a year.

Q. Did you or your department during your years in issue regularly review the Platt's Oil Gram?

A. We review the Oil Gram every day.

Q. I have here a sample copy of a Platt's Oil Gram, which I would like you to identify, but with permission of counsel for respondent, I would like to put a Xerox of that into the record instead of the original, in that they are supposed to take the original back to Houston.

(Exhibit 26 marked for identification)

By Mr. Ragatz:

Q. Would you describe what has been marked as Exhibit 26, please?

A. This is the March 1, 1966 edition of the Platt's Oil Gram, it has both the news service and the price service sections.

Q. And just for purposes of illustration, would you point out where the Gulf Coast prices are shown?

A. On the back page, which is Page 6A of the price service, and on the Xerox I guess it is still the last page of

the Xerox, just about one-third of the way up from the bottom it shows, "GULF COAST-CARGOES, ALL PORTS, FOB SHIP."

Q. Just quickly, what relation does that price category have to product moving into the State of Wisconsin in Humble's operation?

A. Well, in Humble's operation it is directly related to the price of product moving into Wisconsin.

Q. Explain the use of those prices, would you, please?

A. Well, during the time period involved, products were sold between the Refining and the Marketing Department based on a formula tied to the posting in Platt's, and it was a discounted formula based on the history we had had of our third-party sales to Standard Oil of Kentucky.

These prices are a day-to-day type price and historically if someone wanted to make a long-term contract or a large contract, they could effectively negotiate a discount off of this price, and that is how we established our transfer price to Marketing from Refining.

Q. What kind of circulation does this publication have, if you know?

A. Within Humble or within the industry?

Q. Within the industry.

A. I suspect it is the most widely-read publication in the industry.

Mr. Ragatz: I would like to offer Exhibit 26 in evidence at this time.

Mr. Timken: Any objection, Mr. Shapiro?

Mr. Shapiro: No objection to the exhibit other than it affecting the respondent's audit insofar as transfer prices are concerned, I believe it may relate to the same objection we previously made with respect to transfer prices as not being relevant to our apportionment formula.

Mr. Timken: Exhibit 26 is received.

Mr. Shapiro: Subject to the objection?

Mr. Timken: Subject to the objection.

By Mr. Ragatz:

Q. Mr. Campbell, do your duties relate to acquisition of products for sale to the public by the Marketing Department?

A. Yes, sir.

Q. Where do you obtain these products?

A. Well, from all sources. If we need product, I go to the people in the industry who I think have surplus product for sale and try to arrange for a purchase.

Q. Did any Humble refined fuel products go to marketing in Wisconsin during the 1965-1968 period?

A. No, sir.

Q. Where did you obtain the products which were sold in Wisconsin during that period?

A. There were two sources. The majority of the products was received on the Pure exchange out of Lemont, Illinois, and the balance was a small purchase that we had with the Great Southern Refining Company up in Junction City.

Q. Where is Lemont, Illinois located generally?

A. It is on the west side of Chicago, the best I can remember.

Q. This morning a copy of the Pure exchange agreement was introduced into evidence as Exhibit 25, and I wonder if you might comment first in clarification as to the crude oil exchange aspect of that agreement based upon your understanding of the arrangement in connection with your duties.

A. The crude oil arrangement was established back in the late 50's when the government first imposed the import program and started issuing quotas. It was an arrangement whereby Pure was anxious to get the imports into the system and made the arrangements with Exxon so they could bring in foreign crude to use their foreign tickets, and we gave back crude as was designed to go back up to Lemont.

Q. This was related to that special situation import ticket arrangement that Mr. Jeager described?

A. Yes, sir.

Q. During the years in issue were there any other crude oil straight exchange agreements to your knowledge in this country?

A. None other than these that were set up to take care of the quota situation.

Q. Other than this foreign quota situation you don't have any crude exchange?

A. No, sir.

Q. Explain briefly the product exchange aspect of the Pure agreement, if you would.

A. The products exchange portion of that was set up at the time Humble was expanding in the Midwest market, and we were trying to develop a way to get products into the Midwest market.

Pure, who had more refining capacity than they had marketing requirements in the Midwest, was anxious to find a way to get products to the East Coast so in effect we set up a products exchange where they gave us products in Chicago and we returned products to them at Bayway, New Jersey.

Q. Now, when the Supply Department acquired products from Pure and transferred them to the Marketing Department, what price was used?

A. The transfer price for these products was based upon the third-party sale contract number that we talked about earlier, the discounted Platt's price plus the location differential which reflected the cost of moving the product from the Gulf Coast to Chicago, and on that, whatever pipeline costs or terminal costs were required to get it into the trucks where marketing could use it.

Q. Was there also a discount factor?

A. Oh, yes.

Q. Would you describe that?

A. The discount factor was one which was established, I guess, around 1961 or possibly '62 and negotiations between marketing and refining were based on the history of the Standard Oil of Kentucky contract. It was decided a discount of 24 cents or 25 cents a gallon would be given from refining, sales and marketing.

Q. This was a discount applicable on Platt's price?

A. Yes.

Q. What was this contract with Standard Oil of Kentucky?

A. That was the contract where—well, for years Esso, Standard Oil and then Humble was selling products to Standard Oil of Kentucky.

Standard Oil of Kentucky was an independent marketer marketing in five states in the Southeast and we sold them the majority of their products.

Q. Was there any corporate affiliation between Standard Oil of Kentucky and Standard Oil of New Jersey or Humble?

A. No, sir.

Q. Standard Oil of Kentucky was a separate independent company?

A. Yes, sir.

Q. Did the price as set, as you just described, fluctuate during the period 1965 through 1968?

A. Constantly.

Q. And how did you keep track of this price then, or maybe you could describe the fluctuation.

A. Each day as Platt's was published, if there was a change in the cargo price of Platt's on that day, the transfer price to marketing would change to reflect the change in Platt's.

Q. So it directly followed or correlated the changes in Platt's?

A. Right.

Q. How was the price determined in situations where no Platt's price was available?

A. There has never been a time that I have been aware of that there hasn't been a Platt's price.

Q. Now, Platt's relates to your principal product, I take it?

A. Yes.

Q. What about minor products where Platt's doesn't have a quotation?

A. The minor products I think you are referring to are the greases and waxes and the motor oils, and Platt's does have some basis for that, but generally these are proprietors' products that are blended up to meet specific formulas and have certain additives.

Q. Did you have other sales of comparable products to third parties that you could refer to for pricing?

A. Only the base stock which are covered in Platt's.

Q. This would enable you to make a buildup and determine the price for the product?

A. It gave you a starting point of the arguments between refining and marketing.

Q. Was there a buildup on the basic price between refining and marketing for transportation and terminal costs?

A. Was there a buildup; yes, the transfer price to marketing was also set at a base point at the refinery tail gate and from that point the cost was built up to reflect what actual costs took place or what change location differential was involved and so forth.

Q. Now, as to transportation into Wisconsin from Lemont, did that occur in Humble-owned pipelines?

A. No.

Q. Were the terminals in Wisconsin owned by Humble?

A. No.

Q. So the third parties involved in setting the transportation and terminal costs were added as buildup to the price?

A. Yes, we negotiated with them, but not by pipelines. They had posted tariffs, but for the terminal fees.

Q. Was there also a buildup for the price fuel additives?

A. The additives in the State of Wisconsin were products not coming from directly our refinery. The additives were shipped up to the terminals on a separate basis, injected at the rack. These costs were paid by marketing as an addition to their basic costs and the transfer price to marketing reflected the products that they received and did not include the additives.

Q. Who actually determined at what price the transfers would be made between refining and marketing?

A. Once the negotiations were completed on the basic transfer price, which was related to Platt's, that set the cost of getting the product to other locations. If it was an exchange, like all of the material going into Wisconsin was done, that was done by the negotiations that I or my predecessor made with the exchanging company to get products at that point.

Q. How did this procedure carry out the Humble policy of functional profitable independence?

A. It maintained that the marketing was paying a price comparable to what they would have had to pay if they were going on the open market to buy from another refinery.

Q. How did this procedure affect the ability of both marketing and refining to be competitive with independent marketers and independent refineries in the industry?

A. Well, from the refining standpoint, the price that refining was getting from their products was comparable to what an independent refinery would get if they were selling products on an open market on daily prices, and it also gave marketing the same base point from which to operate as if an independent marketer had gone on the open market.

Q. Were the products that Humble acquired from Pure at Lemont refined from Humble-produced crude oil?

A. I don't believe so.

Q. What was the major purpose of that exchange agreement as to products that you already described?

A. The major purpose of the exchange agreement is to reduce the products from the normal production source to the point of where it is sold.

Q. Is there any real difference between the exchange as you operated it and a purchase or sale of the product?

Mr. Shapiro: Objection; calling for a legal conclusion.

Mr. Timken: Objection sustained.

Mr. Ragatz: If I might, the question I am attempting to ask the witness relates to his experience of the operation of the exchanges. I am not intending to ask for a legal conclusion as to whether there is a legal difference between an exchange relationship and from his operation of it. I think I should be entitled to ask him whether there were any mechanical differences.

Mr. Shapiro: It doesn't have that implication.

Mr. Timken: Maybe you can rephrase the question, Mr. Ragatz.

By Mr. Ragatz:

Q. Do you in your department handle purchases and sales of products as well as exchanges?

A. Yes, sir.

Q. Now, in the mechanical operation of an exchange, is the procedure different on an exchange than if you were purchasing or selling?

A. Yes, there are two basic differences.

Q. Will you describe them?

A. Well, purchase and sale are not necessarily related and most generally are not. You purchase and pay cash for the product you sell or you sell and collect cash for the product you deliver.

On an exchange the arrangement is set up so that the only money that changes hands is the differential in the location or the quality of deliverance and the basic value of the product is exchanged for in kind rather than a dollar value being exchanged and dollars changing hands.

Q. Other than the differential for quality and location, the exchange would be a purchase paid for in kind?

A. It could be set up that you would make a complete purchase for the product that you received and then a complete sale of the product you are delivering, but there are two problems. One, you have a lot of money changing hands, and, two, you sort of lose control over the exchange portion of the operation if you don't work it on a balanced basis.

Q. Is the exchange process a common process in the industry?

A. Yes, sir.

Mr. Timken: Back on the record.

Mr. Ragatz?

By Mr. Ragatz:

Q. Mr. Campbell, when and where did Humble obtain title to the products which were transported to Wisconsin for sale?

A. The products in some cases, the title was transferred at Lemont, Illinois on those that we arranged for shipment up through the West Shore Pipeline and others were obtained. We obtained title as they were loaded in the trucks. This is the fuel products, the main products we are talking about.

Q. I think I already asked you whether these pipeline charges for transportation to locations in Wisconsin were incurred to Humble on the pipelines?

A. Yes, you asked me that and the answer was no.

Q. How were the product prices determined at the tailgate of Pure's Lemont refinery?

A. The prices were determined based on our formula for the base transfer price at the Gulf Coast locations and then we added to that the location differential to get up there.

Q. This is the same procedure you previously described?

A. Right.

Q. Was it necessary to determine prices to account for imbalances under the exchange agreement with Pure?

A. The only time that would be necessary would be at the end of the year if it was an imbalance in the exchange; and in order to reflect that in the inventory the price would be assigned to the product but that would be the same value as any other barrel that was in the refinery at the time.

Q. And the prices would also be set in relation to Platt's? Same manner?

A. Yes.

Q. Now were all of the refined fuel products which the Supply Department acquired and transferred to Humble's Marketing Department priced for transfer purposes at a third-party price set in relation to Platt's?

A. No, sir. The small amount that we purchased from Great Northern was transferred to Marketing at the price we were able to negotiate in our purchase from Great Northern.

Q. But other than that were they all set in relation to third-party prices?

A. Yes, sir.

Mr. Ragatz: No further questions.

Mr. Timken: You may cross-examine.

Mr. Shapiro: Thank you.

Examination

By Mr. Shapiro:

Q. Mr. Campbell, is your position with the company in the Supply Department?

A. Yes, sir.

Q. Certain characteristics of gasoline affect the performance of an automobile, isn't that true?

A. Yes, sir.

Q. For example, starting and warm-ups, vapor lock, are controlled by the hydrocarbon composition of the gasoline?

A. Yes, sir.

Q. Now, fuel economy, engine knock and carburetor icing are controlled by a combination of hydrocarbon composition and fuel additives, are they not?

A. Repeat the three again?

Q. Fuel economy, engine knock and carburetor icing are controlled by a combination of hydrocarbon composition and fuel additives?

A. Right.

Q. In 1967 did Humble develop a carburetor detergent additive to reduce maintenance and operating costs?

A. We have a constant research program going on. I don't know what years they—

Q. An additive does have some effect in eliminating emission pollution, does it not?

A. Yes, sir.

Q. Did you develop an additive known as HTA?

A. Yes, sir.

Q. And was that during the period in question?

A. That was much later, I believe.

Q. Might it have been as early as 1968?

A. No, I think it was '70 or '71, I think, before HTA came out. I may be wrong.

Q. Now you considered HTA, this additive, as improving the distribution of gasoline to the individual cylinders of the engine and as a detergent, didn't you?

A. It had many uses, yes.

Q. Are such additives of Humble made available to other oil companies? They are patented, are they not?

A. Yes, sir. I believe this one was.

Q. So that is it true that the formulas are known only to Humble?

A. I really can't answer to that.

Q. Is a significant part of research and development devoted to improving the quality of gasoline?

A. Yes, sir.

Q. Now an automobile gets better mileage with a heavier gasoline, isn't that correct?

A. Right.

Q. However, starting and warm-up is more efficient with a lighter gasoline?

Mr. Ragatz: I would like to interject to object on the basis that this seems pretty far afield and I question the relevance; and I guess I would like to submit an objection based upon the relevance of what all this mechanical, technical stuff after the years in issue has to do with the issues in this case.

Mr. Timken: What are you trying to develop, Mr. Shapiro?

Mr. Shapiro: We are not dealing with the years after the years in issue here, sir. What we are describing for the Commission, to make the record as complete as possible, are characteristics of the principal product of this company, gasoline. And certainly if that's not relevant, I don't know what is.

I would like to add, Gentlemen, if I may, that, as I think I may have indicated before, the principal issue in the case is unitariness and unitariness cuts across the entire operation of the company. And for that reason also I submit it is relevant.

Mr. Timken: Mr. Shapiro, we will allow Mr. Ragatz, and Mr. Shapiro, we will allow the witness to answer these questions but not as to product that were produced outside of the years in question.

Mr. Shapiro: Very good.

By Mr. Shapiro:

Q. In blending a gasoline, Mr. Campbell, is it not necessary to sacrifice or trade off certain qualities, for example, to get maximum mileage you must reduce the starting and warm-up characteristics?

A. Yes, sir.

Q. The blending process in Humble refineries is accomplished with the aid of computers, is it not?

A. It is today.

Q. Was it in 1968?

A. I don't know when we first put our first computer in. I don't think it was in '68.

Q. Are seasonal variations taken into account, that is, is a different gasoline manufactured for winter than that manufactured for summer?

A. At our refineries the gasoline qualities are changed daily.

Q. So that there are finer variations taken into account?

A. Yes, sir.

Q. For example, when the company is marketing gasoline in Illinois or Wisconsin where seasonal changes in temperature occur fairly rapidly, does the time lag in delivery from refinery to service station cause problems at times, that is, in connection with planning for changes in temperature?

A. No, sir. We have divided the country up into about 35 or 40 different zones from a temperature standpoint and when products are produced at the refinery to be moved to those zones, the time lag associated, whether it is a pipeline movement or a barge movement, and the normal amount of time to go through the terminal before the product is delivered to the service station is taken into effect and back calculated in one month as to what the qualities are going to be required when it's actually sold.

Q. Do those different geographic areas require different blends of gasoline?

A. Yes, sir.

Q. Did the octane ratings increase during the years in issue?

A. I don't recall.

Q. If they might have increased, this would have resulted from a variety of complex and costly refining processes, isn't that true?

A. Not necessarily.

Q. What would it result from?

A. You can change the octane level of gasoline just by the quantity of lead that you put into the product and also by a change of the component you use to blend the particular gasoline.

Q. Is the gasoline produced by one of Humble's refineries the same chemical mixture as that made by another company?

A. It wouldn't be exactly the same; it would be generally the same type of ingredient.

Q. That is before the additive package is put in?

A. Yes, sir. But we all have different goals we are shooting for as to what mixture we want between start-up and mileage and so forth.

Q. Your operations include quality control or monitoring of your gasoline which is sold by the dealer, doesn't it?

A. Yes, sir.

Q. Does Humble sample the gasoline in order to assure, to have assurance of quality?

A. In most areas we have relied on the ethyl survey which, up until just recently, has picked up samples from service stations all over the country. In those areas where ethyl was not picking up samples, we had our own programs for picking them up.

Q. So that is done at various points in the distribution point in the distribution system?

A. Yes, sir.

Q. Does Humble have product standards covering such octanes as volatility, vapor pressure stability, lead content and uniformity of quality?

A. Well, the last one comes by the enforcement of the standards of the first ones, yes, sir.

Q. Is the purpose of quality control to assure that the gasoline sold under Humble's trademarks meets quality standards?

A. Yes, sir.

Q. And the goodwill that's associated with it?

A. Right.

Q. Do the additives used by Humble require special equipment and efforts for mixing into the gasoline?

A. No, sir.

Q. Is the additive a rather thick substance that would tend to settle at the bottom of a storage tank if it were merely dumped in?

A. Not if it's made right.

Q. At what point in the distribution system is the additive mixed into the gasoline?

A. For a refinery-produced gasoline the additives are mixed in at the refinery. For product that's picked up at the exchange location, it is injected into the gasoline at the loading rack.

Q. Is the additive packaged, is it placed in certain containers?

A. It's generally shipped to the exchange areas in drums. In small locations it can be shipped in small cans that will be the right size for a particular compartment on the truck.

Q. Is it manufactured by Humble?

A. Not always.

Q. But in some cases?

A. Some cases. Not by Humble itself. I guess there is a distinction between Humble and the other affiliates.

Q. The additive is a composition of chemicals resulting from the company's R and D, isn't that right?

A. Yes, sir.

Q. And did you answer the question as to whether it's covered by the patent?

A. I said I didn't know.

Q. Do you have any knowledge as to whether it might be covered by the patent?

A. Well—

Mr. Ragatz: I think I got to object. He asked the witness the question, the witness said he didn't know and then he asked the same question again.

Mr. Timken: I think that's right, Mr. Shapiro. Objection sustained.

Mr. Shapiro: All right.

By Mr. Shapiro:

Q. The gasoline received from an exchange partner is refined according to Humble's specifications, isn't it?

A. It's either refined according to Humble's specifications or it meets certain basic criteria that we have to have before we will accept exchange gasoline.

Q. I believe you testified that additives are injected at the rack. Can you spell out exactly what the rack is?

A. The rack is the position in a terminal where a truck pulls under and it's called the rack because it looks like a framework. And a truck pulls under and the loading iron comes down and the gasoline is poured in the truck and there are projectioneering pumps set up at that rack and as you push the button the additive injection pump is also activated and injects an additive at the same time, and that would have been the situation in Wisconsin.

Q. Are there basically two types of exchange agreement, long-term and short-term?

A. Yes, sir.

Well, the same type of agreement. There are two types; some run for long periods and some are for short.

Q. Is the long-term agreement more significant and widely used in your company?

Mr. Ragatz: Objection. I don't understand what he means.

Q. Is the long-term agreement more widely used in your company than the short term, one to three years, say?

A. To my knowledge we have never had an exchange agreement that ran as long as three years. We have done some checking recently and we make more spot short-term exchanges on a yearly basis than the continuing type you are referring to.

Q. I believe you testified that an exchange results in the savings of transportation costs, is that correct?

A. Yes, sir.

Q. There is a considerable time lag between the manufacture and the use of gasoline, isn't that right?

A. It can run—

Q. Up to 30 days?

A. It could be that long in certain terminals, yes.

Q. Now this time lag between refinery and the consumer means that the refiner must plan very carefully for the manufacture of the right type of fuel, is that right?

A. Yes, sir.

Q. And if the weather is unusually warm or unusually cold this may create problems?

A. Yes. The basic blending formulas are set up based on a 20-year average of what the weather has been and that's continually reviewed and updated so that we can have the best—we can predict, based on the average of weather. And you get Indian Summer or a cold snap in the South, you can have problems.

Q. Is there another problem to overcome as the result of this time lag and that is to prevent the gasoline from adversely changing characteristics during this period?

A. The stability controls that are built into it would keep it from changing characteristics.

Q. Is there a tendency for some components of the gasoline to combine with the oxygen in the air to form gum or varnish?

A. That is one of the tests we control for.

Q. And is this tendency slowed down by additives called antioxidants?

A. Yes, sir.

Q. Do some metals act as a catalyst and tend to speed up this process?

A. Would you repeat that question?

Q. Well, are there additives that are called—I will rephrase it.

Are certain additives called metal deactivators?

A. Yes, sir.

Q. What do they do?

A. To the best of my knowledge if a certain sweetening process is used in the refinery that you can come up with some chemical forms in the gasoline that would react with certain type piping or tank walls and these metal deactivators control that so you don't get the inter-reaction between the gasoline and the metal that it comes in contact with.

Q. Since the gasoline must be transported, stored and delivered, what housekeeping methods are used to avoid getting dirt, rust and water in the gasoline?

Mr. Ragatz: I am going to object again to the relevance of this. Anybody who markets gasoline or refines it is going to try to keep it clean. What possible relevance does that have to this proceeding?

Mr. Shapiro: I am not going to develop this much longer but these are important questions.

Mr. Ragatz: I will stipulate that they try to keep it clean. How about that to save time?

Mr. Shapiro: I just don't think you like the questions for other reasons.

Mr. Timken: Gentlemen, I will concede I have trouble seeing the relevance of these questions also; but I don't think we should cut Mr. Shapiro off. Perhaps he will be able to develop them. But I do agree with Mr. Ragatz that I don't see the immediate relevance, Mr. Shapiro. But I am going to allow you to continue irregardless of that.

Q. Since the gasoline must be, Mr. Campbell, transported, stored and delivered, what housekeeping methods are used to avoid getting dirt, rust and water in the gasoline?

A. It is a conventional-type operation where there are spot checks made, samples taken at various points in the production and in the transportation operation to make sure that there hasn't been contamination, and since you are generally using facilities that have been set aside for the sole purpose of moving the gasoline and so forth, the chance of outside dirt and so forth getting in are very remote.

Q. So that good performance of the gasoline to the consumer is the end result of a long chain of events to insure quality control, isn't that right?

A. Yes, sir.

Q. How many departments of the company have you worked with, sir?

A. I have worked with Refining, Marketing, and Supply.

Q. Do you know of other instances where key employees are transferred from one department to another?

A. It is quite frequently.

Q. I have no further questions.

Mr. Timken: Mr. Ragatz?

Redirect Examination

By Mr. Ragatz:

Q. I don't want to dwell on this, but I think maybe for the record I would like to ask you whether independent marketers look for particular quality in the gas they acquire?

A. The independents have certain criteria they look for just like everyone else.

Q. Do they worry about the mixture of the gasoline as applied to weather or season conditions?

A. Oh, yes.

Q. Do they worry about the cleanliness of the gas?

A. Certainly.

Q. The performance of the gas?

A. Certainly.

Q. How about independent refineries? Do they use the same or similar protective ingredients and procedures as Mr. Shapiro asked about?

A. Yes, sir.

Q. Do they work for quality control?

A. Certainly.

Q. Cleanliness?

A. Yes.

Q. Good performance?

A. Yes, sir.

Q. No further questions.

Mr. Timken: Mr. Shapiro, any re-cross?

Examination

By Mr. Shapiro:

Q. These efforts that are generally referred to by Mr. Ragatz extend over the entire company, do they not? Quality control and so forth?

A. Well, quality control starts at the time of refinery trying to manufacture the product to meet certain specifications right through the transportation operation to keep

the quality that was built into it and marketing to make sure that the same quality gets to the service station, yes, sir.

Q. I have no further questions.

Mr. Timken: Thank you, Mr. Campbell. You may step down. You are excused.

(Witness excused)

Mr. Timken: Mr. Ragatz, you may call your next witness.

Mr. Ragatz: The petitioner calls Robert Koonce.

ROBERT KOONCE, called as a witness, having been first duly sworn under oath, testified as follows:

Examination

By Mr. Ragatz:

Q. Would you state your full name for the record.

A. Robert Dean Koonce.

Q. Where do you live?

A. Pasadena, Texas.

Q. How old will you be on Thursday?

A. That is irrelevant.

Q. Will you please answer the question.

A. Forty.

Q. What is your educational background?

A. I have a high school equivalency, 1954, and I received an BA degree from Lee Junior College in 1962, and a BBA degree from the University at Houston in 1966.

Q. Would you describe your employment history.

A. I have worked for the past eight and a half years for the Humble Oil and Refining Company, and prior to that I worked for Goodyear Tire and Rubber Company for almost twelve years, and then I was in the Marine Corps for about two and a half years.

Q. Would you describe the duties of your present position?

A. I supervise the filing of state income and franchise tax returns and federal tax returns.

Q. And how long have you been in this position?

A. I have been in a supervisory position for about three years.

Q. What is your precise title?

A. I am a Senior Tax Specialist.

Q. What was your involvement with Mr. Sheridan's audit of Humble for the years 1965 through 1968?

A. At the time of that audit I was assigned the responsibilities for filing the Wisconsin Franchise Tax Return and I worked with Mr. Sheridan during the field audit.

Q. Are you familiar with Exhibit 1, which has been admitted into evidence in this proceeding?

A. I am.

Q. And that constitutes the Notice of Assessment letter and accompanying audit report?

A. It does.

Q. And that is the audit report by Mr. Sheridan that you just described?

A. That's correct.

Q. Can you describe Mr. Sheridan's conclusion in his transmittal letter that accompanies the audit report in terms of whether or not the company was considered as a unitary business with its Wisconsin operation as an integral part—

A. I can read for you this letter. Okay, it says that, "The additional tax results from a change of method of reporting income to Wisconsin. Since Humble Oil and Refining Company is a unitary company and its Wisconsin business is an integral part thereof, formula apportionment of the company's income is mandatory and separate accounting is not permissible."

Q. When did you first learn of this conclusion?

A. When Mr. Sheridan came into our office.

Q. And approximately when was that?

A. February of 1970.

Q. And if you know, how close was that to the time he commenced the audit?

A. That was when he commenced the audit.

Q. And upon what do you base the belief that he had reached the unitary conclusion at that time?

A. Well, he did not want to audit the separate accounting returns. He said that that didn't make any difference, since we were unitary, that he was going to perform the audit similar to the audit that had been performed by Mr. Kaspar.

Q. Are you familiar with the document called the "Longhorn paper" which has been admitted into evidence in this proceeding as Exhibit 11-12-B?

A. I am.

Q. I show you that exhibit and ask you to describe particularly the latter parts of it?

A. It is an outline of certain questions that apparently are supposed to be asked in the determination—in making the determination as to whether a company is a unitary business.

Q. Prior to the time this document was produced for us in January as part of our discovery proceeding, had you ever seen this document?

A. Not with this cover on it. I have seen a document similar to this outline which was produced after the suit had already been filed in Wisconsin.

Q. And the commencement of the audit or at anytime during the audit, did Mr. Sheridan discuss with you the factors that are set forth in the Longhorn paper?

A. He did not.

Q. Now to clarify again, when did you say you saw a document similar to that Longhorn paper?

A. In about January of 1972 Mr. Sheridan was in Houston conducting another audit, I guess, and he came by and asked us to answer the questions in a document similar to this.

Q. Was that the first time he asked you for such information?

A. That's correct.

Q. And when had his audit been completed?

A. His audit had been completed in May of 1971.

Q. And if you know, when had this present case been commenced.

A. I think suit was filed in December of '71.

Q. Now on what basis had Humble reported the results of its operations during the years 1965 through 1968?

A. It had filed its Wisconsin returns on the basis of separate accounting.

Q. Was this consistent or inconsistent with its prior reporting processes to the State of Wisconsin?

A. It was consistent.

Q. Would you explain the reporting pattern beginning in 1956?

A. Well, in 1956 the Pate Oil Company, which was subsequently merged into Humble Oil and Refining Company, was operating wholly within the State of Wisconsin and filing its returns on the basis of separate accounting, and after the merger in July of 1960, Humble continued to file its returns on the basis of separate accounting.

Q. During this period, say, from 1960 on Humble was operating the Wisconsin operations of the former Pate Company. Were separate accounting records maintained as to Wisconsin sales and expenses?

A. Yes, they were.

Q. Was a record of Wisconsin sales maintained in the Milwaukee District Office?

A. A record of these sales were so maintained.

Q. Were all these sales made to outsiders?

A. They were.

Q. Other than a minor reconciliation as just described, did Mr. Sheridan dispute the amount of sales reported?

A. He did not.

Q. Did Mr. Sheridan challenge the reported cost of goods sold?

A. He did not.

Q. Was the cost of goods sold as reported consistent with Humble's books and records?

A. The cost of goods reported was taken from Humble's books and records.

Q. Was the cost of goods sold determined from third-party prices in the method described by Mr. Campbell?

A. I believe that to be correct.

Q. Were the same methods used to determine the cost of goods sold for other states in this geographical area?

A. They were.

Q. How were the operating expenses determined which we deducted on Wisconsin returns?

A. Most of the operating expenses were determined by a state code that was assigned to these expenses, and specifically identified with the State of Wisconsin.

Q. Now, I show you one of the returns for the four years in issue; this being 1967, and ask you if you can identify for me any expenses claimed thereon as deductions which were not separately recorded on your books and records?

A. On Page 1 of the 1967 return, the advertising expenses were not separately maintained as to Wisconsin, and the area and administrative expenses set forth on Schedule 1 of Page 4 of the return were not specifically identified with the State of Wisconsin.

Q. Now, was the same true for the other three years in issue?

A. That's correct.

Q. And were these the only expenses allocated to the State?

A. These were the only operating expenses that were allocated to the State.

Q. And how were these allocations determined and from where were these expenses allocated?

A. These expenses were allocated on the basis of the sale realization method taking Wisconsin sales to the total; for example, area sales to get a percentage and were multiplied to the area expenses and that part of the area expenses were assigned to Wisconsin.

Q. Was this method of allocation to Wisconsin any different than allocations to any other states in the region?

A. It was not.

Q. Was the accounting for these allocations consistent each year?

A. It was.

(Exhibit 27 marked for identification)

Q. I show you what has been marked as Exhibit 27 and ask you to identify what that represents.

A. This is a summary of the operating expenses allocated to Wisconsin for separate accounting purposes.

Q. Was this prepared at your direction?

A. Yes, it was.

Q. Would you describe what this exhibit shows?

A. This exhibit shows that what expenses were allocated to Wisconsin and for two of the years, 1966 and 1967, it shows that if all of the allocated expenses were disregarded, we would still have a loss, and for 1965 if 60 percent of these allocated expenses were totally disregarded, we would still have a loss, and for 1968 if you disregard about 85 per cent, you would still have a loss.

Q. Now, were the figures on this schedule taken from the company's tax return as filed in Wisconsin?

A. They were.

Mr. Ragatz: I would like to move the admission of Exhibit 27.

Mr. Timken: Any objection?

Mr. Shapiro: No objection.

Mr. Timken: Exhibit 27 is received.

By Mr. Ragatz.

Q. Based upon your understanding and your familiarity with the accounting records of Humble, were the expenses as reported on the Wisconsin returns including those allocated as accurately as possible reflect these expenses attributable to Wisconsin?

A. They were.

Q. Would you repeat what would have been the result even if these expenses would have been eliminated in the returns in substantial part for each of the years in issue?

A. As I stated before, if you eliminate for 1966 and 1967 all of these expenses, you still have a loss, and if you eliminate most of the expenses for 1965 and possibly '68, you still have a loss.

(Exhibit 28 marked for identification)

Q. I show you what has been marked Exhibit 28 and ask you if you can identify that.

A. I don't know how you want me to identify it.

Q. Explain what it is.

A. If you turn to—I guess I can explain it by the table of contents.

Mr. Ragatz: I wonder if before we do this we might have a recess?

Mr. Timken: We will take ten minutes.

(Recess)

Mr. Timken: Back on the record. Mr. Ragatz, you may proceed.

By Mr. Ragatz:

Q. I believe just before we broke, I handed you an exhibit what's been marked Exhibit 28. And would you explain what that document is?

A. That document is a summary of alternative methods of attributing income to Wisconsin to demonstrate the substantial overreach of the State's hybrid apportionment formula.

Mr. Shapiro: I object to the conclusion contained in that statement. It certainly is a conclusion, an "overreach".

Mr. Timken: I think the witness can answer, Mr. Shapiro. You can certainly cross examine him on his choice of words. But you in effect are not objecting to the question but you are objecting to the answer.

Mr. Shapiro: I didn't know the question would provide that answer.

Mr. Timken: Well, I think you can explore that on cross examination if you so desire. I am afraid I will have to overrule the objection to the answer.

By Mr. Ragatz:

Q. Where were the figures shown on the schedule contained in this exhibit obtained?

A. They were obtained from the audit report and from Humble's books and records.

Q. And do they constitute a summary of figures shown in Humble's books and records?

A. They do.

Q. And did you prepare this summary?

A. I prepared part of it and part of it was prepared under my supervision.

Q. Were the books and records from which the summary was prepared maintained in the ordinary course of Humble's business?

A. They were.

Q. And were these books and records prepared contemporaneously or within a short time after the transactions they reflect actually occurred?

A. That's correct.

Q. Do you have the original record computer runs from which these summaries were prepared in court today?

A. I do.

Q. Now are these two boxes of books those computer runs?

A. That's correct.

Q. Let the record show the witness is referring to two large cardboard containers containing books. And I show you one of these books as an example; and would you explain what that book contains?

A. This is a computer run of Humble Oil and Refining Company's separate company 1965 federal income tax return.

Q. And are the other books contained in the two boxes just mentioned similar runs for other years?

A. They are similar runs for the other years during this audit.

Q. And what other kind of computer run records are contained in those boxes?

A. Our assets by state records, computer runs are contained in those boxes.

Q. And do those boxes contain all of the figures necessary to support the figures contained in this Exhibit 28 Schedule other than, of course, the State's figures that are also reflected in here?

A. These boxes together with the audit report are my sources for preparing this.

Q. Did Mr. Sheridan, during the course of this audit, have a full opportunity to examine the company's books and records?

A. He did.

Q. How much time did he spend in Houston if you recall?

A. Oh, I'd say a little better than three weeks or so.

Q. All of this was on the audit of Humble?

A. That's correct.

Q. And what was the time span of the total audit?

A. Let's see. The audit commenced in February of 1970 and we received the assessment notice I believe in May of 1971.

Q. Now referring again to these books and records were they kept under your supervision or that of your Department?

A. They were.

Q. Were they physically maintained in your Department's office in Houston?

A. They were.

Q. And did you cause them to be brought here today?

A. I did.

Q. Now would you look at Schedule A in this Exhibit 28 and would you explain this summary shown of Schedule A?

A. Well, the summary that's set forth on Schedule A is the summary of alternative methods of attributing income to Wisconsin. The first two sets of columns represent the taxable income and the tax obtained by use of the State's hybrid apportionment formula.

The second set of columns sets forth the net losses and tax, zero tax, for Humble's separate accounting Wisonsin operations. The third set of columns sets forth the taxable income and the tax if you apportion the marketing function within or without Wisconsin and with the allocation of specific items under the law.

And the fourth set of columns represents the apportionment of combined marketing and refining income within and without Wisconsin with the allocation of certain items under the law. And the last set of columns represents the treatment of the Exploration and Production Department as a separate business or as allocation to situs under

the law with the other allocable income allocated to situs as provided by the law the balance of the income apportioned under the law.

Q. What was the reason for preparing alternative taxable income and tax calculations?

A. Well, because of the complex nature of the State's formula, it was about the most vivid way that I could think of to demonstrate the overreach of the State's method.

Q. Now would you compare for the Commission the results aggregated for the four years of using the state's hybrid apportionment formula compared with the results of Humble's separate accounting reporting?

A. The difference between those two methods?

Q. Uh-hum.

A. The difference in taxable income between the state's hybrid apportionment method and Humble's separate accounting return, there was a net change in income of approximately eight and a half billion dollars with a tax of $316,000.

Q. All right. Now let's turn to Schedule B. And since we looked at the 1967 return, let's turn to the 1967 Schedule B? Would you explain what this Schedule shows?

A. This schedule sets forth each of the Department's taxable income for the year 1967.

Q. And these figures reflect the manner in which your books and records are kept?

A. They do.

Q. And so that each functional department has its separate set of records?

A. That's correct.

Q. Now were the books and records of each department maintained consistent with the policy of functional profitability independence?

A. I believe that to be correct.

Q. And these figures shown in this schedule for 1967 show the results of those operations on the company's books and records?

A. That's correct, with the tax adjustment.

Q. Now what was the purpose of preparing this Schedule D?

A. The purpose of preparing this schedule was to demonstrate that our federal taxable income is calculated by departments.

Q. Now in preparing the separate departmental profit and loss schedules what transfer prices were used on crude oil transferred from the Exploration and Production function to the Refining Department?

A. Posted field price.

Q. And were the transfer prices used between the Refining Department and the Marketing Department consistent with the procedures described by Mr. Campbell?

A. I believe that to be correct.

Q. And was the transfer value of natural gas transferred between Exploration and Production and Refining consistent with the procedures described by Mr. Carter?

A. I believe that to be correct.

Q. And you indicated that posted field prices were used on the transfer from E and P to Refining and was that consistent to the procedure described by Mr. Jeager?

A. That's correct.

Q. Now were the accounting procedures consistent in each of the years in issue as to each of these departments?

A. They were.

Q. So that each of these Schedule B's contained in this exhibit reflect what the books and records show as to the departmental profit or loss for each of the four years in issue?

A. That's correct.

Q. Now were the results of each functional department's operations evaluated by the company on the basis of their functional operating statements?

A. I believe that to be correct.

Q. Did the Wisconsin Department of Revenue review the results of the functional accounting?

A. No, they did not other than the auditor reviewed the federal return from which these numbers were taken.

Q. Now in the course of the audit and subsequently assessment of Humble for the years in issue, did the Department respect the integrity of Humble's functional net profit determination as to any function?

A. They did.

Q. Would you explain that?

A. Well, one of the calculations in the audit report involves taking the Exploration and Production Department income and determining what part of that is considered under their interpretation as being allocable to situs and being in the nature of income from mining. And the balance of the income was treated as apportionable with the allocation of certain specific items.

Q. Now can you point out in the State's audit report, which is Exhibit 1 in this proceeding where the net profit of the Exploration and Production Department was used?

A. It's set forth on Exhibit E-4-1 of the audit report.

Q. And let the record show that you are now referring to the document that's been admitted into evidence here as Exhibit 1?

A. That's correct

Q. What figure is shown for 1967 as the net income of the Exploration and Production Department?

A. Two hundred and fourteen million, two hundred twenty-eight thousand, nine hundred fifty-one dollars.

Q. And would you point out where that same figure appears on your schedule B?

A. It's the bottom number in the first column of figures on Schedule B—1967, Page 101.

Q. Now referring again to the same page of Exhibit 1 do the figures for the E and P net profit correlate with your schedule as to each of the other years?

A. They do.

Q. Did the State in any way make an examination to test the integrity and validity of the transfer prices between E and P and Refining which were used to arrive at that E and P net income?

A. Not to my knowledge.

Q. Did the State dispute in any way the functional accounting as to any other function?

A. Not to my knowledge.

Q. And did—

A. Except they made some kind of adjustment for administrative expense, but that's all.

Q. Did the State in any way make an examination to test the integrity and validity of the transfer prices between Refining and Marketing functions?

A. It did not to my knowledge.

Q. Now in addition to E and P, Refining and Marketing, Schedule B shows other functional operating departments. Would you explain how the company treated each of these other departments?

A. Each of these other departments are profit centers and they are treated as—as if you would treat a separate business for a Marine Department, and also for the Coal and Shale Oil Department, Minerals Department and Land Management Department.

Q. Would you explain the relationship of the Coal and Shale Oil Department to Minerals and the Land Management Department to the location of the operations that each conducted?

A. Well, the business that was conducted by the Coal and Shale Oil Department has previously been explained as the Exploration and Production for coal and shale oil, and those expenses in 1967 were incurred at the situs of where those operations were conducted.

Q. Was there any production or mining of coal and shale oil in any of the years in issue?

A. I don't believe so.

Q. Would you make the same explanation relating to the Minerals Department?

A. Well, the Minerals Department is the department which operates the business of exploring for and producing, if mines are found, hard minerals, and the expenses applicable to those operations are incurred at the situs of those operations.

Q. Was there any production or mining of minerals during the period here in issue?

A. Not to my knowledge.

Q. And would you make the same description as to the Land Management Department?

A. Well, the Land Management Department has the responsibility of operating the business of disposing of surplus property for the company in the most efficient manner possible, and those operations have to do with property that is located within a particular state or area and their site of operation.

Q. Do you know whether Land Management had any Wisconsin properties sold during the years in issue?

A. I believe that there was one during this period.

Q. And do you recall whether or not that was reported as income allocable to situs on the Wisconsin returns filed?

A. It was.

Q. Now during at least one of the years in issue, Schedule B shows a column for Enjay, and will you describe what that is?

A. Enjay for 1965 and the first part of 1966 was the department within Humble that operated the chemical business of Humble Oil and Refining.

Q. Did that business have any Wisconsin activities?

A. Some small minor sales.

Q. Were those sales reported on the Wisconsin return?

A. They were.

Q. Now will you explain how Mr. Sheridan's audit treated each of these departments?

A. I hope I can. The Exploration and Production Department, as I—are you talking about just these latter departments or all of them?

Q. No, just the minor departments?

A. Okay. The Marine Department was treated in the audit report as being the net income from the—the Marine Department was treated as partly allocable and partly apportionable, and the allocable part arose from the chartering of vessels to third parties and was treated as rental income allocable to situs.

The Coal and Shale Oil Department results, with the exception of any minor items that were adjusted in the audit report, the balance of it was treated as apportionable, and the same is true with Minerals, Land Management and Enjay.

Q. Did you provide the auditor with separate profit and loss figures on each of these departments?

A. I did.

Q. I believe I asked you as to Enjay and Land Management, but did Marine have any operations connected with the State of Wisconsin?

A. Not to my knowledge.

Q. And did Coal and Shale Oil have any operations connected with the State of Wisconsin?

A. Not to my knowledge.

Q. And how about Minerals?

A. Not to my knowledge.

Q. According to Mr. Luper's testimony, the E and P function is composed of three departments, Exploration, Production and Natural Gas. How are these treated for accounting purposes?

A. All three of these are treated as one profit center, as the exploration and production data on this exhibit demonstrates.

Q. You are referring to Schedule B of Exhibit 28?

A. That's correct.

Q. And that exploration and production column then constitutes the combination of those three—

A. The business conducted by the exploration and production function.

Q. Now do each of the functional operating departments have their own accounting personnel and maintain their own separate records?

A. They do.

Q. So each has its own accounting department then?

A. Yes, they do.

Q. And for what purposes are the figures of all of these functional operating departments combined?

A. They are combined only for purposes of preparing company-wide financial statements and preparation of the federal return.

Q. Otherwise are they separately maintained?

A. They are.

Q. And is it or is it not true that each functional operating department has a full complement of accounting staff?

A. They do.

Q. Now let's go back to Schedule A of Exhibit 28, and would you explain the alternative approach shown on this schedule where only Humble's marketing function was apportioned?

A. Well, the third set of figures on Schedule A reflect the taxable income and the tax that would result from apportioning the marketing functions income within and without the State after allocation of those items that are required to be allocated under the law.

Q. Why did you make this particular calculation?

A. Again, this was an approach to demonstrate the overreach of the State's hybrid apportionment formula.

Q. Would you point out the difference between Humble's separate accounting reporting and the result of apportioning marketing only?

A. Humble's separate accounting returns reflected 3.9 million dollar loss for the four-year period as compared to taxable income produced of approximately 2.1 million dollars, if you apportion the marketing income within and without the State and allocate certain items to situs, that is a net difference of about six million dollars.

Q. And how can you explain that difference?

A. That difference has to do with innerplay of the apportionment formula, in that all of the Marketing Department's income is apportioned uniformly by the use of this apportionment formula without regard to where the incomes are.

Q. Well, would you explain the impact of the different kinds of marketing areas on the result that you get in that calculation?

A. Well, what you do is, through the use of the apportionment formula, as testified by Mr. Luper, we have expansion areas in our Marketing Department and we have mature areas, and these expansion areas are opearting at a substantially less profit than the mature areas are realizing, and through the use of the apportionment formula you shift that income from those mature areas to the expansion areas.

Q. Would you compare the difference between the results on this calculation that is apportioning marketing only and the result reached by the State in reaching its hybrid apportionment formula?

A. There is, an indicated by the little B on Schedule A, the net difference between this calculation and the State's average calculation demonstrates an average of approximately two and a half million dollars of income under this theory.

Q. Does that mean that even if you assume that the marketing function should be apportioned, ignoring the difference between expansion areas and mature areas in marketing, that even assuming that, the State's application of the hybrid apportionment formula still produced two and a half million dollars for income?

A. That's correct.

Q. Does Humble agree with the approach of apportioning marketing only?

A. It is an alternative that we think our separate accounting return more properly shows our income attributed to expansion transactions in Wisconsin.

Q. Would you explain Schedule D on Exhibit 28?

A. Exhibit D?

Q. Correct.

A. Schedule D contains the calculations that support the summary that we were just looking at over on Schedule A, and we have started off with the Federal Taxable Income applicable to the marketing function. We have adjusted that to the Wisconsin basis and deducted these other deductions that are provided by law, and then allocated these items that are required to be allocated under the law.

Then on Page 2 we have calculated a factor using the marketing attributable within the State, the total marketing attributable and a portion of the apportionable income

on page 1 within and without the State based on that formula using the three factor formula as provided by law.

Q. The result then is the taxable income and tax as shown on Page 1 of Schedule D which would result if you only apportioned marketing?

A. That's correct.

Q. And these results are reflected back—

A. On the summary on Schedule A.

Q. Now, would you explain the next alternative where refining and marketing are combined?

A. Schedule A, the four set of figures on Schedule A reflect the taxable income and tax that would be generated by combining the Refining and Marketing Departments' income and apportioning it within and without the State under the law and allocating—after allocation of these items that are required to be allocated.

Q. Would you explain the difference in the results of that approach as compared to separate accounting?

A. Well, Humble's separate accounting returns reflected a net loss of 3.9 million dollars for the four-year period and under this approach it would produce taxable income of about 1.9 million so that there is a net swing of about 5.8 million dollars.

Q. And how do you account for that kind of a difference in addition to what you have explained already in connection with the marketing function?

A. Well, the difference is further explained by the interplay of each function's income, and the interplay of the proportionate share that each of these functions contribute to the factor attributes which have an effect of uniformity distributing this income without regard to where it is earned.

Q. Why did you make this calculation, combining marketing and refining?

A. Well, I made it to further demonstrate the substantial overreach of the State's hybrid apportionment formula.

Q. Does the company keep combined records on marketing and refining?

A. They do not.

Q. Does the company agree with this approach?

A. It is an alternative, but we think that our separate accounting return more properly reflects our income from operations in the State of Wisconsin.

Q. Now, would you explain Schedule E on Exhibit 28?

A. Schedule E is the calculation of the information that is set forth on the four set of figures on Schedule A and on Schedule E we have combined the Marketing and Refining Departments' income, federal taxable income, converted it to a Wisconsin basis, taken these deductions that are provided by law and allocated that income which is required to be allocated, and the balance of the income is apportioned within and without Wisconsin based on the formula that is obtained on Page 2.

Q. Now, were the Marketing Department's figures maintained on the policy of functional profitability independence?

A. That is my understanding.

Q. And adjusted to the Wisconsin basis?

A. That's correct.

Q. Were the Refining Department's figures maintained on the policy of functional profitability independence?

A. That's my understanding.

Q. And adjusted to the Wisconsin basis?

A. That's correct.

Q. And for purposes of Schedule E, you have combined the figures of the two departments?

A. That's correct.

Q. And then computed the taxable income on the basis of the statutory apportionment formula?

A. That's correct.

Q. And these figures on the bottom of Schedule E are reflected on the summary of Schedule A?

A. That's correct.

Q. Would you describe the difference between the result of that calculation and the result of the State's hybrid apportionment calculations as reflected on this audit?

A. The net difference between the State's hybrid apportionment calculation—the taxable income is approximately four and a half million dollars. These calculations produced taxable income of about 1.9 million dollars and there is about 2.6 million dollars overreach of income outside of the State of Wisconsin.

Q. All right. Now, while we are still talking about marketing—

(Exhibit 29 marked for identification)

Q. I show you what has been marked Exhibit 29 and ask you if you can identify and explain what that is?

A. This is a comparison of net income from the Marketing Department with the assessed income from the Wisconsin marketing operations.

Q. Was this prepared at your direction?

A. It was.

Q. Where did the figures shown on this exhibit originate?

A. The first two set of figures were taken from the audit report and the second set of figures, other than the percentage figures, were obtained from the Marketing Department's books and records.

Q. Were these the same books and records we previously described?

A. That's correct.

Q. Would you describe the relationship shown on this exhibit?

A. Well, for the four-year period, the percent of assessed taxable income per dollar of Wisconsin sales was approximately 7.5 percent whereas the Marketing Depart-

ment's net income on the Wisconsin basis, the percent of that to the Marketing Department's sale overall was approximately 3.2 percent.

Q. Then according to the State of Wisconsin, the operation in Wisconsin earned over 2 and one-third times the dollar sales as did the whole marketing function?

A. That appears this is what this means.

Q. Now, considering the separate accounting results and the methods that you described and your background with Humble, do you know of anyway Humble's marketing operations could have earned two and one-third times per dollars of sales as did the whole marketing functions?

A. I believe it has already been established that Wisconsin is an expansion area which is less profitable; as a matter of fact, it operated at a loss over this period as compared to some mature marketing areas which produced substantial income, and that even these facts would even further distort this relationship between these two numbers, and that 3.2 percent on here assumes that all the marketing sales produced proportionately the same amount of net income.

Q. Instead of taking Humble's marketing sales and total marketing income converted to the Wisconsin basis, you broke that down between mature marketing areas and expansion marketing areas. Would you describe the relationship between the resulting percentages for expansion marketing areas as compared to the Wisconsin taxable income for the state audit.

A. Well, the expansion areas, because they are less profitable, the percent of net income per dollar of sales would be substantially less than the overall marketing, and if you took the mature areas, then those percentages would be substantially higher than this average percent, and maybe more in line with the number that is shown on this other relationship part of the audit.

Mr. Timken: Mr. Ragatz, is this a convenient place to break?

Mr. Ragatz: I would like to move the admission of this exhibit before we stop.

Mr. Timken: 28 and 29?

Mr. Ragatz: I am only ready at the moment to offer 29.

Mr. Shapiro: We will object to the relevancy of that exhibit because this approach is again the functional approach taken by the company whereas the respondent submits that a more valid comparison would show Wisconsin sales, Wisconsin's net income total company sales and total company net income.

Mr. Ragatz: I would like to point out that respondent is free to offer any comparison that it thinks is valid, but it is part of the presentation of our case that we think that the contrast shown by this exhibit is highly significant and very clearly demonstrates the overreach of respondent's method.

The relationship of Wisconsin's taxable income in an expansion area of two and a half times the total company's marketing net income very vividly demonstrates how far the state is reaching. We think this is very relevant to the issues, whether the State's application of its apportionment method can be sustained or whether it violates either statutory or constitutional, or both requirements.

Mr. Timken: We will receive Exhibit 29 for what it is worth subject to respondent's objections, and before adjourn I would just like to say for the record Mr. Shapiro raised some questions of terminology. I would like to explain to both parties that the words used such as "hybrid" and "overreach" are the petitioner's descriptive words and their description of what happened. This, of course, will not control our decision obviously.

Anything further today; if not, we will adjourn until 9:30 tomorrow morning.

(Proceedings adjourned)

(4:30)

STATE OF WISCONSIN — WISCONSIN TAX APPEALS COMMISSION

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),
Petitioner,
vs. Docket No. I-3806

WISCONSIN DEPARTMENT OF REVENUE,
Respondent.

CERTIFICATION

KAREN A. CHERRY
MINDLA COMINS
LORETTA PETERS,

hereby certify that as the duly appointed reporters, we took in shorthand the testimony and proceedings had in the foregoing matter on the 7th day of October, 1974, and that the attached is a true and correct transcription of said shorthand notes and of the whole thereof.

Dated this 7th day of October, 1974.

/s/ *Karen A. Cherry*
Karen A. Cherry
/s/ *Mindla Comins*
Mindla Comins
/s/ *Loretta Peters*
Loretta Peters

TRANSCRIPT OF PROCEEDINGS in the above-entitled matter held before the Wisconsin Tax Appeals Commission, in Room 229, City-County Building, Madison, Wisconsin, on the 8th day of October, 1974, commencing at 9:30 in the forenoon.

Mr. Timken: Back on the record. You are sworn, sir?
The Witness: Yes, sir.
Mr. Timken: You may continue, Mr. Ragatz.

ROBERT D. KOONCE, recalled as a witness, having been previously sworn under oath, testified as follows:

Direct Examination

By Mr. Ragatz:

Q. Mr. Koonce, before we recessed yesterday afternoon we had been discussing Exhibit 28. And I would ask you now to explain the alternative approach shown on Schedule A of that exhibit relating to the treatment of Exploration and Production as a separate business or as allocated to situs?

A. Okay. The last set of figures on Exhibit A to the far right-hand side sets forth the taxable income and the tax that would be generated if Exploration and Production were treated as a separate business or it was allocated to situs under the statute. And in view of the fact that the exploration and production function is treated as a separate business, none of which is conducted within and without the State of Wisconsin, it follows that it should be allocable to situs.

Q. Is that the rationale for that alternative?

A. That's correct.

Q. And would you explain the rationale for the treatment of the income as situs income?

A. The rationale for treating of the income as allocable to situs is that the production of oil and gas as related

in the audit report is in the nature of income from mining and, therefore, should be allocated to situs.

Q. Now did the net income of the E and P function as recorded on the company's books reflect the income derived from the production of oil and gas by Humble during the years in issue?

A. Yes, it did.

Q. Now I believe you have already indicated that the Department of Revenue respected the integrity of this figure by using it in its calculation?

A. That's correct.

Q. Now based upon your knowledge of Humble and its records can you state whether the E and P net income was in any sense created even in part by business within the borders of the State of Wisconsin?

A. It was not.

Mr. Shapiro: That calls for a conclusion. I object.

Mr. Timken: Will you read the question.

(Question read)

Mr. Timken: Mr. Ragatz?

Mr. Ragatz: Well, the question is intended to be a factual question based upon this man's intimate knowledge of the accounting record of the company and his background with the company. And, granted, it's hard to unscramble totally opinion from fact if the answer I am soliciting is intended to be a factual answer.

Mr. Shapiro: Gentlemen, I would like to submit, if I may?

Mr. Timken: You sure may.

Mr. Shapiro: That one of the principal issues in the case is whether the E and P Department is part of the unitary business along with the other parts of the company and whether any income generated by the E and P Department is attributable to business done in Wisconsin. That's a fundamental issue.

Mr. Timken: Now, Mr. Shapiro, it seems to me that the ground we are covering here has already been covered. I think we will allow the witness to answer the question. I don't think it is the first time we have had this information, so we will overrule your objection and allow the witness to answer. And your objection is noted for the record.

Mr. Ragatz: I believe the aswer is already on the record.

By Mr. Ragatz:

Q. Mr. Koonce, also based upon your knowledge of Humble and its records can you state as a matter of fact whether the income of the E and P function was fully earned at the point where the oil and gas was available for disposition?

Mr. Shapiro: Same objection.

Mr. Timken: Same ruling.

The Witness: It was.

By Mr. Ragatz:

Q. And also whether the refining and marketing functions served to increase or decrease the amount of the production income of the E and P Department?

A. It did not.

Q. Now turning back to Exhibit 28 could you explain why you made the calculation shown on Schedule C; and, again, because we used '67 as a model before, let's look at Schedule C for 1967.

A. The reason that I made this calculation was, again, an alternative approach to demonstrate the substantial difference between the audit assessment and this approach and to demonstrate the overreach of the State's hybrid apportionment formula calculation.

Q. Now would you explain the schedules and material shown on Schedule C?

A. Well, on Schedule C on Page 1 of Schedule C for 1967 we have set forth the federal taxable income by function and made all of those adjustments that were made in the audit report and converted the federal taxable income by function back to a Wisconsin basis and then taking those other deductions that are provided by law.

And then over on Page 2 it sets forth the net allocable income, the income which follows the residence of the taxpayer and the income which follows the situs of the property. And the next calculation of that allocable income is brought back over on Page 1 and deducted from the total income and that net allocable income includes the total income of the Exploration and Production Department, the Coal and Shale Oil Department, the Minerals Department and the Land Management Department as well as those other items that are allocable either to the residence of the taxpayer or to the situs of the property under the law.

And then those were deducted on Page 1 from total net income on a Wisconsin basis to get to apportionable income.

And then on Page 3 the factor was calculated using those factor attributes attributable to the apportionable income; and then the tax was—Added back was the Wisconsin allocable income as determined from the audit report. And then the results of this year along with the other three years are summarized over on Schedule A.

Q. Now would you explain the result of that calculation as shown on Schedule A?

A. Well, the result of that calculation produces a taxable income of approximately two million dollars as compared to the State's audit method which produced four and a half million dollars. And this demonstrates, again, the overreach due to the interrelation of all of those adjustments that were made in the State's calculation, an overreach of about 2.6 million dollars.

Q. Can you describe the difference between the results of this approach and the results of the separate accounting?

A. Our separate accounting return for the four years indicated a net loss of 3.9 million dollars. This approach produced approximately two million dollars of taxable income; so there is a net increase even under this approach of about 5.9 million dollars between our returns as filed and this alternative.

Q. Now does Humble agree with this approach?

A. Well, it's an alternative but, again, we think that our separate accounting returns more properly reflect our operations in the State of Wisconsin.

Q. How about the treatment of E and P income as income to situs under the statute? Does Humble agree with that approach?

A. Definitely.

Q. But that would go along the separate accounting approach; it would be implicit in the separate accounting approach, I believe?

A. That's correct.

Q. Now looking at Schedule A, the set of figures where only refining and marketing were apportioned as compared to the exclusion of the exploration and production net income, would you explain why there is a difference between those two calculations?

A. Well, here again you get involved in an interplay of the income derived from each business as compared to its contributions to the factor attributes as provided under law, and that interplay of factor attributes in relation to the income of each one of these businesses changes this result somewhat.

Q. It is really only a small change, isn't it?

A. Yes, it is.

Q. Now you have already testified that Humble uses posted field prices as to crude oil for purposes of accounting for the E and P function operations. What value does Humble use in accounting for gas operations of the E and P function?

A. We use the sales price to third parties.

Q. Is this the so-called field price that Mr. Carter described?

A. That is part of it. The field price applies to that income which—or that which is applicable to internal transfer.

Q. And the rest of the gas went at third-party contract prices?

A. That's correct.

Q. For the internal transfers of gas, was the field price determined in arriving at E and P net income in the manner described by Mr. Carter?

A. It was.

Q. Is this field price of gas a well head price?

A. Yes, it is, in most instances.

Q. And where the field price is net at well head price, how do you obtain a well head price?

A. Well, if the field price is not the well head price, if the field price applies to a transfer, internal transfer, after it has been processed through a plant, gas plant, then you use what is commonly referred to in the industry as a Fiske formula to work that price back to what the value is at the well head.

Q. Why do you need to obtain a well head value?

A. You have to determine the well head value both for oil and for gas, for purposes of computing depletion, for purposes of paying severance taxes to the various states, and for purposes of settling with royalty owners and for purposen of settling with other interest owners.

Q. Now as to crude oil, is the posted field price a well head price?

A. That's correct.

Q. And that can be used directly for those purposes you have just enumerated?

A. That's correct.

Q. As to gas, where the field price is not a well head price, you have to make this Fiske formula calculation?

A. That's right.

Q. Now would you describe the acceptance of the income derived by the E and P function for depletion purposes?

A. Would you read that back?

(Question read)

A. The prices that we were just talking about, the posted field prices and the well head prices, are readily acceptable for depletion purposes.

Q. How about for severance tax purposes?

A. The same is true for severance.

Q. And for royalty purposes?

A. The same is true for royalty purposes.

Q. And for the purpose of valuing working interest?

A. That's correct.

Q. On the Wisconsin audit was any review made of the calculation and determination of these various expenses for categories you just discussed?

A. Well, I really can't say other than to know that our books and records were available to the auditor and he reviewed our financial statements and our federal returns, and these deductions are set forth in the—especially the depletion and severance taxes are set forth in those records.

Q. And these were not challenged?

A. Not to my knowledge.

Mr. Ragatz: At this time I would like to move the admission of Exhibit 28.

Mr. Shapiro: We must object to the irrelevancy of Exhibit 28, particularly with reference to the computations included therein that have for their import the divided or functional accounting that the company uses as distinguished from the method that is used by the Department for Wisconsin income and franchise tax purposes of considering the entire company on an apportionment basis.

Mr. Ragatz: If I might be heard, I would like to say that counsel has now summarized the key issue in the case, and for petitioner to be denied the admission and consideration of this exhibit would deny the Commission an opportunity to examine the petitioner's arguments as expressed in the accounting numbers on the various points raised in this petition.

The matters set forth in these exhibits are summaries: we have laid a proper foundation of the business records rule for the admission of these summaries, and we submit that the alternatives here are quite descriptive and should be quite helpful in the Commission's examination of the constitutional and statutory issues, and the issue of the proper application by the Department of its apportionment formula.

So we submit this exhibit is highly relevant to the consideration and determination of the issues in this case.

Mr. Timken: Before the Commission makes a ruling, I would like to ask Mr. Koonce a question regarding this exhibit.

The Witness: Yes.

Mr. Timken: As you have explained each of these alternatives you have mentioned that when Mr. Ragatz asked you the question, "Does Humble accept them," you mentioned they were alternatives, but that Humble prefers the separate accounting basis they reported under, correct?

The Witness: That's correct.

Mr. Timken: My question to you is: are they acceptable alternatives to Humble?

The Witness: They are alternatives which are used in various areas of state taxation.

Mr. Ragatz: If the Commission would, please, when we get to briefing this case, I think we can set forth in the brief authority or lack of authority on certain of these positions, and probably get the alternatives in a better legal context than we can do by just putting it into evidence.

Mr. Timken: Very well. Now we will take a few minutes, gentlemen.

(Recess)

Mr. Timken: Back on the record. As far as Exhibit 28 is concerned, it is the ruling of this Commission that Exhibit 28 will be received subject to objection.

The State will have the opportunity to cross-examination regarding it. It will be helpful in the future for our deliberations so we are accepting it for what it is worth.

You may proceed, Mr. Ragatz.

(Exhibit 30 marked for identification)

By Mr. Ragatz:

Q. Mr. Koonce, can you tell the Commission where Humble obtained the crude oil that was exchanged with Pure at Lemont, Illinois during the years in issue under the foreign ticket exchange agreement mentioned by Mr. Campbell and Mr. Carter?

A. They purchased it from three different purchasers and delivered it to the Lemont refinery.

Q. Let me correct my statement. I meant to state Mr. Jeager, not Mr. Carter.

Now, would you repeat your answer for me?

A. They purchased it from three separate sellers and delivered it at Lemont.

Q. So this was not Humble-produced crude?

A. No, it was not.

Q I just handed you a document that has been marked Exhibit 30. Would you identify what this is, please?

A. Well, this is an exhibit which compares each function's contribution to the statutory apportionment formula, endorses its contribution of the net income adjusted to the Wisconsin basis.

Q. Did you prepare this?

A. Yes, I did, or under my supervision.

Q. Now, would you explain what the term "factor attribute" means in this context?

A. Factor attribute means these three factors that are provided for in the statute, the sales factor and a cost of manufacturing factor and a property factor.

Q. Would you describe further what you have done on the various pages of this exhibit?

A. The first page is a summary of the results of the next four pages which is calculations by years, each function's contribution to the factor attributes as compared to each of these business's contributions to the income.

Q. Now, was this prepared from the same books and records that you described yesterday?

A. Yes, it was.

Q. And these books and records are here in the courtroom today?

A. Yes, they are.

Q. Will you describe what the comparison shows as to the results of the use of the apportionment method?

A. On the summary page on the first page down at the bottom where it says "summary" it indicates that the Exploration and Production Department contributed 22.6 per cent of the factor attributes for this four-year period and they contributed on the average of 74.4 per cent of the income on a Wisconsin basis.

The marketing function contributed 22.3 per cent of the factor attributes and contributed 14.3 per cent of the income, and the Refining Department contributed 51.7 per cent of the factor attributes and 7.7 per cent of the net income, and the other functions contributed 3.4 per cent of the factor attributes and 3.6 per cent of the income.

Q. Now, the column entitled "Per Cent of Income" represents the relative contributions of the various functional departments to the company's overall net income, if I understand it correctly?

A. That is converted on a Wisconsin basis.

Q. And the per cent of factor attributes column, represents the attribution of that income under the factor attributes calculations to the statutory formula?

A. It represents each of these function's contributions of the total factor attributes that are provided under the law.

Q. Can you explain the rather significant differences, say, between the factor attributes for Exploration and Production at 22.6 per cent and its respective per cent of income at 74.4 per cent?

A. Well, this whole exhibit was prepared to demonstrate that between the various businesses that are conducted by Humble there is not a correlation, direct correlation between contribution to the factor attributes and the contribution to income.

Q. Does it demonstrate then a distortion?

A. It demonstrates that, for example, if we are on a full apportionment method and you had a 1 per cent factor attribute, in the State of Wisconsin for every dollar of income that that 1 per cent factor draws into the State of Wisconsin it would be drawing 74.4 per cent in Exploration and Production income, 14.3 per cent of the Marketing income, 7.7 per cent of the Refining income, and 3.6 per cent of the other functions' income.

Mr. Ragatz: I would like to offer this exhibit at this time.

Mr. Shapiro: Same objection on the same grounds.

Mr. Timken: The same ruling. Exhibit 30 will be received subject to objection for what it is worth.

By Mr. Ragatz:

Q. In conducting its audit and making its assessment, how did the Wisconsin Department of Revenue alter the statutory apportionment formula as it applied it to Humble?

A. Well, they altered the statutory apportionment formula by weighting the cost of goods sold factor, cost of manufacturing factor.

Q. Would you explain that?

A. They tried to determine what per cent of Humble's total apportionment sales were sales of manufactured products, and that per cent they used to weight the denominator of the cost of manufacturing factor, and this produced a weight of about 60 per cent times that 100 per cent contribution of the denominator of the cost of manufacturing factor, and that gave a weight of about six-tenths of one per cent to the denominator.

Q. Then instead of the statutory denominator of three, what denominator figure was used?

A. Around 2.6 or less.

Q. Explain the three factors that were actually used in making this calculation.

A. Well, they used a sales factor and made certain adjustments to that sales factor based on what they considered a nonapportionable income. They used this weight for the cost of manufacturing factor and in no way did they ever associate the cost of manufacturing factor with the actual cost of manufacturing in any way.

Q. Explain what figures they used to arrive at this cost —so-called cost of manufacturing for purposes of weighting?

A. They used sales of manufactured products. To get to this weight they used the cost of manufacturing factor.

Q. Is it or is it not a fair statement that then in effect two sales factors were used?

A. You could describe it as that.

Mr. Shapiro: Several questions are calling for conclusions.

Mr. Timken: Objection sustained.

Q. Are there any official prescribed and published rules and regulations explaining the weighting procedure that you just described?

A. No, there are not, to my knowledge.

(Exhibit 31 marked for identification)

Q. I show you what has been marked Exhibit 31 and ask you to identify that document.

A. This is a summary of the Wisconsin hybrid apportionment approach which I prepared.

Q. And for what purpose was it prepared?

A. It was prepared to try to explain to counsel the innerrelationships and to put into some kind of logical sequence the various alternative calculations that are made all through this audit report.

Q. Would you point out on this exhibit where the statutory three-factor formula is changed into what we call hybrid?

A. That is done over under Roman numeral VII.

Q. And would you explain that a little bit? I don't mean through procedural steps; I mean just point out what is done there.

A. They have taken the total apportionable sales as calculated by the auditor and subtracted these items which represent sales of goods that were not manufactured by

Humble, and then they get a ratio of the remainder to the total net apportionable sales, and that is what they used as the weight for the denominator of the cost of manufacturing factor.

Q. And that is the procedure that you just previously described?

A. That's correct.

Q. Now would you point out and explain the so-called barrel formula portion of this overall calculation?

A. Well, the barrel formula approach is set forth in Roman Numeral I.

Q. What's the purpose of this so-called barrel formula portion of the calculation?

A. I will tell you what I think is the income that results. They attempted to trace Humble's production of crude oil and condensate, Humble's net working interest in crude oil and condensate. They tried to trace that, I guess, theoretically through the accounting records and attempt to try to determine what part of that crude oil and condensate that was produced was sold prior to entering the refinery and what part of that crude oil entered Humble's refinery and was converted to other products which were subsequently sold.

Q. Now in the process of the overall calculation what does the State's formula assume as to the net income provided by each dollar of sales of the E and P Department?

A. Could you read that back?

(Question read)

The Witness: The audit report assumes that each dollar of crude oil and condensate sales produces the same percent of net income.

Q. What does the State's application of the formula assume as to the dollar return for each dollar of investment?

A. The State's formula assumes that an equivalent dollar of investment attributes is required to produce the same amount of a percent of net income.

Q. Based upon your familiarity with Humble's operations and its accounting records, are either of these assumptions factually valid?

A. No, they are not.

Q. Would you explain just briefly the variations in net income on various types of sales by Humble?

A. Well, the net income on each sale of crude oil varies from lease to lease depending on the expenses and et cetera incurred applicable to the operation of that lease. And some of them are substantially different than others.

Q. Do any such sales produce losses?

A. I am sure they do.

Q. How does the regulation of gas prices by the FPC affect the uniformity return on certain sales dollars?

A. Well, the gas that is sold in interstate commerce is regulated by the Federal Power Commission, and the Federal Power Commission establishes area rate for gas sales prices, and intrastate sales of gas are not subject to that same regulation. So, therefore, the sales price could be substantially different between those two.

Q. Would you explain the differences in return per dollar investment as to various activities of Humble?

A. Well, this is looked upon, for example, on the drilling of an on-shore well as opposed to the drilling of an off-shore well where the costs are substantially greater than the drilling of an on-shore well, and the investment on an off-shore well is considerably greater than the investment in the on-shore well. There are all kinds of variations that you can get by leasing by well.

Q. Now can you point out in this exhibit some places where in the mechanics of the calculation the State has multiplied a ratio by ratio? In fact, would you take and

indicate on the exhibit in red those places where that kind of a calculation occurs, or at least some of them; and indicate, when you are marking it for the record, where you are making the mark.

A. Under I in the barrel formula, item 2-G is a ratio on a ratio. The net effect of 2-H is also the reciprocal ratio of that G calculation.

Q. Would you make a mark right on each place on the exhibit or maybe draw a line under the ratio times the ratio calculation.

A. In the weight of the cost of manufacturing factor they use a ratio of sales manufactured to these total apportionable sales times the hundred percent weight of the denominator of the cost of manufacturing factor that's provided under the law; and that ratio on a ratio is produced in effect at Item VII-3.

(Answer continued)

A. Also in adjusting the property factor for the nonapportionable percentage of the Exploration and Production Department income as determined under the audit, under Roman numeral VIII.

Q. Now without taking too much time at this, maybe you could point out one more at this time.

A. I don't see one offhand.

Q. All right. I won't press you on it to find any more. Would you explain if you can what results you get when one ratio is multiplied by another ratio?

A. You get a ratio that makes a whole lot of underlying assumptions and produces an estimate.

Q. And if you know, or if you can describe it, what impact does this have on the overall formula calculation?

A. Well, all through this calculation in the audit report the calculations and assumptions, et cetera, that are made are so interrelated and so forth, and so many underlying

assumptions are made in the calculation of these ratios, and when you multiply those times other things to produce estimates and use that estimate to adjust something else, all you come out with is an estimate, which can—may or may not have any relationship to the facts, and it substantially in my opinion, distorts the results.

Mr. Ragatz: I would like to offer this exhibit at this time.

Mr. Timken: Mr. Shapiro.

Mr. Shapiro: We have no objection to the exhibit insofar as it reflects what procedures were followed in the respondent's audit, but there are errors which we will find out on cross examination which we must except from our approval of the exhibit, so that with the exception of the errors which we will point out, we have no objection to the exhibit.

Mr. Timken: Mr. Ragatz, would you establish for the record who actually prepared this exhibit.

Mr. Ragatz: He testified he prepared it, I believe.

Mr. Timken: Is that correct?

The Witness: That's correct.

Mr. Timken: Very well; Exhibit 31 is received and the respondent will be given the opportunity, of course, to explore it on cross examination.

By Mr. Ragatz:

Q. During the testimony of Mr. Carter he pointed out that only approximately 4 percent of the natural gas produced by Humble was transferred to its Refining Department and that the gas transferred was all consumed as fuel and resulted in no products. From the Wisconsin Department's formula have you been able to determine what portion of the natural gas produced by Humble was actually included in apportionable income in the calculation?

A. It is approximately 10 percent of something.

Q. Ten percent is your answer?

A. That's correct.

Q. Approximately two and a half times the 4 percent that Mr. Carter indicated actually went in?

A. That's correct.

Q. What factor or assumption, if you know, contributed the most to this difference?

A. The factor that contributed the most to this difference was the treatment of gas plant gas income as being apportionable.

Q. As I understand the State's theory, it would be that where gas or oil is converted to another product, it loses its allocation to situs under the income for mining portion of the statute. Is that your understanding of the decision?

A. I think that is correct.

Q. Now then, to the best of your understanding, is the State being consistent with its theory when it includes gas plant gas sales and apportionable income.

Mr. Shapiro: Objection.

Mr. Ragatz: I might explain I have laid a proper factual background, both with this witness and the prior witnesses for this witness to state his understanding as to whether the State is being consistent in its application of the theory applied to the facts.

Mr. Timken: Would you read that question.

(Question read)

Mr. Timken: We will allow the witness to answer that question.

A. Based on my understanding of the State's approach, for example in the area of crude oil where theoretically some of the Humble-produced crude, under their formula, gets transferred to the refinery and it is changed into other products and there is an internal transfer and then subsequently sold on down the line, theoretically with respect to

gas—the gas plant gas income——they are not being consistent and not being—well, in that natural gas is produced, it goes to the gas plants, and then it is sold at the tailgate of the gas plants, and this is natural gas when it is produced and it is natural gas when it is sold at the tailgate of the plant, and the only thing that has happened to it is it has had some of the liquids extracted that is in the gas in the plant.

Mr. Timken: We will take ten minutes.

(Recess)

Mr. Timken: Back on the record. Mr. Ragatz?

Mr. Ragatz: I have no further questions of this witness.

Mr. Timken: Mr. Shapiro, you may cross examine this witness.

Mr. Shapiro: Thank you.

Cross Examination

By Mr. Shapiro:

Q. Mr. Koonce, where is the location of your office?

A. It is in Houston, Texas.

Q. Is that in the Headquarters Building that Mr. Luper described?

A. That's correct.

Q. To whom are you responsible?

A. To whom am I responsible?

Q. Yes.

A. To the manager of the Tax Department.

Q. And the Tax Department—do you have before you Exhibit 20?

A. No, sir, I sure don't.

Q. I might just ask, the Tax Department is part of the corporate staff, is it not?

A. That's correct.

Q. I would like to refer you to Exhibit 28, Schedule D, Page 2.

A. All right, sir.

Q. You compute that Wisconsin apportionment fraction by using—let me strike that question.

I would like to ask another question first. Does the Marketing Department perform any manufacturing?

A. Not to my knowledge.

Q. Is your answer no?

A. No.

Q. On this Page 2 you compute the Wisconsin apportionment fraction by using the cost of manufacturing as zero in Wisconsin and dividing the sum of the three percentages of property, cost of manufacturing and sales by three, is that correct?

A. That's correct. The reason I did that—

Q. I will ask you about that. If there is no manufacturing why did you not divide by two rather than three?

A. The reason that I did that is that the statute provides for dividing by three, and I did not have any alternative to divide by two. Only the Department of Revenue has that prerogative.

Q. Are you also aware that the statute provides for the elimination of a factor?

A. On the part of the Department of Revenue.

Q. Or in application?

A. Only on the part of the Department of Revenue.

Q. Next I would like to refer you to Schedule B and that relates to each year on this exhibit. Let's turn first to Schedule B for 1965.

Each column on that page, each column of figures is a functional financial report or statement for that department, isn't that true?

A. That's correct.

Q. Now, if we would add up the individual gross receipts figures on Line number 1 for each department across the line, we would have a pyramiding of sales, isn't that right?

A. If you add up all of these sales across column 1, after the elimination of—

Q. I didn't ask you that.

A. Well, across these columns, the total ties back to the company's total.

Q. You are not answering my question. If we add up the totals of each department, E and P, Marketing and Refining and so on, if we add them up, before we get—I am referring only to the department columns.

A. Administrative is a department.

Q. It would result in a pyramiding of sales, wouldn't it?

Mr. Ragatz: I'm going to object to that question unless he defines "pyramiding" and unless the witness understands what pyramiding means.

Mr. Timken: Does the witness understand what pyramiding means?

The Witness: Well, I don't understand specifically what his question is.

Mr. Timken: Would you rephrase the question, Mr. Shapiro?

The Witness: The totals across all of the top columns on Line 1, the totals by department total back to the company's totals.

By Mr. Shapiro:

Q. Yes, sir. But if we stop—I call your attention to the column entitled "Enjay." That is the last column, isn't that correct?

A. That is the last functional operating department, that's correct.

Q. Now, if we stop there and if we were to add all the figures on Line number 1 for gross receipts, that total figure would result in a pyramiding of sales?

Mr. Ragatz: Same objection.

Q. And an overstatement of sales, would it not?

Mr. Ragatz: If you understand.

Mr. Timken: Do you understand the question? If you don't, say so.

The Witness: I understand the question.

Mr. Timken: Can you answer the question?

The Witness: Yes, sir.

Mr. Timken: Would you answer it, please?

The Witness: It does not overstate each department's sales.

By Mr. Shapiro:

Q. That does not answer the question, sir.

A. You said—

Q. Would it result in an overstatement of total sales, if we stop at the point that I indicated?

A. It represents the sales of each department before elimination, if that is what you are driving at.

Q. The E and P Department's transfers to refining are set up as the Refining Department's cost of sales, isn't that true?

A. That's correct.

Q. And the Refining Department's transfers to marketing are set up as the Marketing Department's cost of sales?

A. That's correct.

Q. It is necessary to eliminate certain intracompany transfers because a transfer from one department to another department is not a sale to an outsider, isn't that true?

A. That's correct.

Q. Now, these eliminations are made in the column entitled "Administrative," correct?

A. That's correct.

Q. For the year 1965 these eliminations are in the amount of two billion two hundred and seventy-four million fifty-nine thousand eight hundred eighty-seven dollars?

A. That's correct.

Q. And voting for the year 1967 in Schedule B, these same eliminations are two billion five hundred seventy-three million—round it off at that point, isn't that correct?

A. That's correct.

Q. And for 1968 we have similar—I skipped 1966; I'm sorry.

For 1966 it is two billion three hundred sixty-three million, and 1968 is two billion six hundred ninety-one million, isn't that correct?

A. I think that's right.

Q. Do you follow?

A. I didn't catch your first number for 1966.

Q. Okay. 1966, Schedule B, the elimination is two billion three hundred sixty-three million?

A. That is correct.

Q. Going back to 1965, similar eliminations are made for the cost of goods sold on Line number 2 for each year?

A. That's correct.

Q. And the same is true with respect to Line number 3, is that right?

A. The elimination that is in Line 3 represents an adjustment to inventory.

Q. Well, let's consider then the principal eliminations in the billions of dollars referred to for gross receipts and cost of goods sold only. After these eliminations we arrived at a total company figure, did we not?

A. That's correct.

Q. Why are these eliminations made?

A. They are made only for purposes of the preparation of the Federal Tax Return and also for the preparation of the company's total income and expense table.

Q. So that for these purposes, the total figures on the right are the significant figures?

A. The far right?

Q. Yes, sir.

A. The total column?

Q. Yes.

A. For the total company, that's correct.

Q. Now, Mr. Koonce, on direct examination yesterday you testified that Pate Oil Company reported its Wisconsin operations beginning in 1956, isn't that right?

A. That's my understanding.

Q. Now, did Pate do any of its business outside of Wisconsin?

A. Not to my knowledge.

Q. So they reported all of their income to Wisconsin that fall, isn't that correct?

A. That's correct.

Q. I believe you testified that they reported on a separate accounting basis?

A. That's correct.

Q. Now if Pate was not a multi-state corporation, and you concede to that, and reported all of its income to Wisconsin, will you explain why you refer to that reporting as a separate accounting reporting?

A. Well, it was a separate accounting for Pate's operations within the State of Wisconsin as reflected by their books and records.

Q. Separate from what?

A. Separate from outside the State of Wisconsin.

Q. Did they do any business outside the State of Wisconsin?

A. No, they did not.

Q. Then why do you have to separate?

A. Well, it just reflects the summary of their accounting results within the State of Wisconsin on this separate basis conducted within the State of Wisconsin.

Q. How do you know this, Mr. Koonce?

A. I have seen the Pate return.

Q. You have seen the Pate returns?

A. Yes, sir.

Q. Based on your knowledge of the Pate returns is it a correct statement that for the four years just prior to Humble coming into Wisconsin Pate reported very substantial amounts of Wisconsin taxable income?

A. I don't know what those numbers were off the top of my head.

Q. But you have seen the returns?

A. They did have some taxable income.

Q. You don't know the amounts of net income reported?

A. I don't remember off the top of my head.

Q. Do you remember approximations?

A. I wouldn't with any given year.

Q. But based on your knowledge Pate was a profitable operation, was it not?

A. Well, from the returns I saw they had taxable income. I don't know if that makes them profitable or not.

Q. Now during the audit years Humble earned a higher rate of return from its investment in E and P than it did in Refining and Marketing, is that true?

Mr. Ragatz: Objection. What relevance has that got to the issues in this case? That sounds like anti-trust.

Mr. Timken: Mr. Shapiro?

Mr. Shapiro: I will move on to another question.

Mr. Timken: Are you withdrawing that question?

Mr. Shapiro: Yes, sir.

By Mr. Shapiro:

Q. Mr. Koonce, you have testified that you didn't like the State's average return on investment formulation because the returns vary from one aspect or segment of the business to another. Now tell us for the period in question what the return on investment was for E and P?

Mr. Ragatz: Same objection.

Mr. Timken: It sounds like anti-trust; would you explain that for us?

Mr. Ragatz: First of all, Mr. Shapiro is characterizing in his question something that I don't believe the witness testified to. I think the witness testified that different activities such as off-shore operations as opposed to on-land operations earn different returns; but he didn't characterize it by function.

Mr. Timken: Mr. Shapiro?

Mr. Shapiro: He testified as a differentiation. He testified as to different rates of return being proper or different segments of the business.

Mr. Ragatz: No, he did not. He testified only that the State's assumption that a uniform rate of return was factually incorrect. He did not testify what the rates of return are; and I don't think he could testify what they are.

Mr. Timken: Are you objecting on a relevance basis then, Mr. Ragatz?

Mr. Ragatz: Yes. I don't believe that this is relevant. First of all, it was not covered by the direct examination. But I don't believe it's relevant and I am not at all sure that this witness could answer it even if the Commission deems it relevant.

Mr. Timken: Well, as both parties know, since the inception of this hearing we have been giving the parties wide latitude as far as relevance is concerned. It's our belief that we should get as complete a record as possible; and at times the relevance might seem dubious to the other party.

We have allowed the petitioner to explore that because we are not a court of record and we have that function. And we think we should allow as complete a record as possible. We have allowed the petitioner that and we intend to allow the respondent leeway in relevance until it becomes patently irrelevant to us.

Mr. Ragatz: I would like to make a further statement if I might.

Mr. Timken: Yes.

Mr. Ragatz: I made this statement on the record on Friday when we were arguing another objection; but I am concerned and do not intend to sit quietly as to questions that bear basically on anti-trust ramifications and not on the tax-ramifications. This is not an anti-trust matter in any degree. This Commission has tax jurisdiction and no other jurisdiction; and we are not about to see our client subjected to anti-trust inquiry that might or might not be useful in some other proceeding. And so then I will be requesting and objecting, if necessary, to any inquiry that I deem to be beyond the scope of this Commission's jurisdiction or the scope of this proceeding.

And, as I indicated on Friday, that, if necessary, I would instruct the witness not to answer such an inquiry or, if he is required to answer it, consider taking an interlocutory appeal on it. We feel very strongly that anti-trust has no place in this proceeding and, when Mr. Shapiro starts talking about functional return on investment, I can only think that his inquiry is anti-trust-oriented and not tax.

Mr. Timken: That's why, Mr. Ragatz, I asked you whether your objection was relevance or anti-trust.

Mr. Ragatz: I am sorry. I had forgotten that you were not here when I made that argument on Friday.

Mr. Timken: That argument was reviewed with me so I was aware of it.

Mr. Shapiro: I would like to respond.

Mr. Timken: Yes, you may.

Mr. Shapiro: If a question may have some relevance to anti-trust, it also may have relevance to the issues involved herein. And because it may have an anti-trust relevance, we submit that having the question answered for our purposes here is entirely proper.

Mr. Timken: I would agree with Mr. Ragatz that we should not get into anti-trust matters.

Mr. Shapiro: I agree.

Mr. Timken: At this point I don't see how that question bears in an anti-trust fashion; and I have opened argument on that respect. If you can show us the anti-trust relevance, we will stop the questioning along that line because I agree we shouldn't get into anti-trust matters. I don't see how this has any bearing on us, Mr. Ragatz.

Mr. Ragatz: It seems to me it puts the reverse burden on the petitioner. It seems to me that the burden should be on the respondent to show that his position is relevant to the inquiry. I don't know what question the return on investment of the E and P function—why that should be relevant to the tax inquiry.

Mr. Shapiro: He has testified regarding return on investment. We are developing that.

Mr. Timken: Now maybe we had better go back to the question. Would you read it to me, the one that's in issue here under discussion? Can you get that far back?

(Question read as follows: Mr. Koonce, you have testified that you didn't like the State's average return

on investment formulation because the returns vary from one aspect or segment of the business to another. Now tell us for the period in question what the return on investment was for E and P?)

Mr. Timken: Mr. Ragatz, we are going to allow the witness to proceed. I assume you will be protecting your client's interest and, of course, in response to your comment about taking interlocutory appeal, you, of course, may do that if you don't agree with us. But by the other token, up here we have to make the rulings as we go along and the parties may not agree with them. But we are going to make them based on our own judgment.

We will now let the witness answer that question. Your objection is noted and if he gets into anti-trust, I will assure you we will stop it because we don't think he has a right to go into that. So the witness may answer if he can.

The Witness: Would you read the question back again?

(Question read)

Mr. Ragatz: Yet another interjection I would like to interpose and that is there is no foundation for this question which I have also indicated, but also there is no foundation as to what counsel means by "return on investment" or how counsel is asking this be calculated. And I think it will develop that this witness does not have that kind of information in the first place, so maybe we are all wasting our time.

Mr. Timken: Could you define what you mean, Mr. Shapiro?

Mr. Shapiro: Well, the witness is an accountant and percentage return on investment I submit should be very familiar to him.

Mr. Timken: Can the witness answer this question; do you understand the question?

The Witness: As to rate of return on the investment?

Mr. Timken: Can you answer it?

The Witness: I don't have any figures here to answer that question.

Mr. Timken: Can you answer the question yes or no?

The Witness: Yes, sir, I can answer yes or no.

Mr. Timken: And what is your answer?

The Witness: No.

Mr. Timken: You are right. It was moot. He said, "No."

Mr. Shapiro: He said, "No"?

Mr. Timken: He said, "No."

By Mr. Shapiro:

Q. Isn't it true, Mr. Koonce, that the federal tax structure encourages Humble to take as much profit as possible in E and P?

Mr. Ragatz: Objection. Now that's asking for a conclusion that's unwarranted. If he wants to draw that conclusion in the brief, he can do that. But I don't think he needs to ask our witnesses whether the company distorts its figures.

The witness has testified as to the procedure used to arrive at the functional net profit and including the net profit of the E and P function all related to federal income tax purposes. If counsel wants to draw conclusions, he can draw them in his brief.

Mr. Timken: Mr. Shapiro, you may be heard.

Mr. Shapiro: The respondent is treating the company as a whole pursuant to its apportionment method. And it is apparent, of course, that the company seeks to exclude from the apportionment method the E and P function.

What the respondent is getting at are reasons and bases for loading profits into the E and P function, and thereby depriving, under their version of this case, Wisconsin

of its legitimate share of the net income of the entire company.

Mr. Timken: Now may I have the question read back to me so I have it in proper context?

(Question read)

Mr. Timken: Do you want to say something, Mr. Ragatz?

Mr. Ragatz: Well, I would submit that if counsel would stipulate that Humble's E and P function does not belong in Wisconsin taxable income, then the source of this inquiry, as far as it goes to facts and not legal conclusions might be pertinent. But the Department has already used the E and P net income of this taxpayer in its own calculations; and it seems a little strange for it to be now challenging the determination of that E and P.

And I submit that the reason this inquiry is made and this whole line of questions is based upon the theory of the respondent's expert witness which is an anti-trust theory that profits are unreasonably raised at the E and P functional level. And if the Commission wants to let the respondent's expert witness testify to that, it will be over our objection. But I think we can reserve that until that occurs.

But as to this witness, I don't think that's a proper question and, among other things, it's asking him to draw a legal conclusion which he is not qualified to draw.

Mr. Shapiro: There have been innumerable conclusions called for by petitioner's counsel; and we submit they have been permitted—the witness has been permitted to answer them.

Mr. Timken: Now, then, Mr. Ragatz, I agree with you that we will have to await to see if and when the Department's expert witness does attempt that procedure. We will sustain your objection on the matter before us at this moment.

By Mr. Shapiro:

Q. Mr. Koonce, are any expenses or costs allocated to Wisconsin under your separate accounting method that relate to the investment account?

A. That relate to the investment account?

Q. That is, the cost of these funds.

Mr. Ragatz: I guess I don't want to keep interrupting, but there was nothing on direct examination that related to funds of the company, and there is no foundation for this cross examination question, plus I don't even understand the question.

Mr. Timken: Does the witness understand the question?

The Witness: No, sir, I sure don't.

Mr. Timken: Would you rephrase the question?

Mr. Shapiro: Sure.

Mr. Timken: I should inform the witness if you don't understand the question I wish you would say so it can be rephrased.

The Witness: Okay.

Mr. Shapiro: I withdraw that question. Could we take five minutes.

Mr. Timken: We will take ten minutes.

(Recess)

Cross Examination

By Mr. Shapiro:

Q. Mr. Koonce, would you please refer to Exhibit 31, Page 3.

A. I don't have the exhibit.

Q. You don't have it before you?

A. Okay.

Q. Roman numeral III-2—are you there? Income which follows commercial domicile?

A. Yes, sir.

Q. What is your understanding of the term "commercial domicile?"

A. My understanding of "commercial domicile" is the location from which the operations of the business—excuse me—it is the location at which the taxpayer has its principal place of business.

Q. And is that distinguishable from another type of domicile for a corporation?

A. Yes, it is.

Q. And what is the other type?

A. The legal domicile.

Q. And is it your understanding that Wisconsin—the Wisconsin Franchise and Income Tax Law provides that dividends and interest income shall follow commercial domicile?

A. That is my understanding. That is what the auditor indicated.

Q. When did he indicate that?

A. During the audit.

Q. Which auditor?

A. Mr. Sheridan.

Q. Verbally?

A. Yes. That certainly is not unusual.

Q. What is not unusual?

A. For dividends and interest to follow the taxpayer's commercial domicile, sir. It is done everywhere.

Q. But that is your understanding as to Wisconsin law?

A. Yes, sir.

Q. You stated that the profit per barrel of crude oil can vary considerably from lease to lease and the cost of producing oil from off-shore wells can be substantially higher than the cost of oil from on-shore wells, is that true?

A. That is correct.

Q. Do your accounting records show the costs and net profits broken down for each well or lease?

A. We have to determine net income from the property for depletion purposes, yes, sir.

Q. Can you trace each barrel of oil from the well head to its ultimate destination either into your own refineries or to other third-party purchases of crude?

A. I cannot.

Q. If you were asked to determine a method as to how much net income was attributable to crude oil sold before entering your refineries, could you devise a method better than that used by the auditor?

A. The net income from all—would you repeat that?

(Question read)

A. Yes, sir, I think I have done that in the Exhibit 28, and all of it is applicable to the—that all of the income from the production of oil is set forth in my Exhibit 28 as Exploration and Production Department income and that income is the income attributable oil prior to entering the refinery.

Q. Are you referring to your Schedule A of Exhibit 28 in the columns over to the right?

A. Well, let's go back and look at any year where Exploration and Production income is set out, and that income is set out in here as Exploration and Production income, and it is the income prior to entering the refinery.

Q. Where is that set out specifically?

A. For example, on Schedule B—

Q. Schedule B?

A. Yes.

Q. For what year is that?

A. For, say, 1967.

Q. Schedule B, 1967, okay. Where is the amount?

A. Where is the amount?

Q. What are you referring to on that page, sir?

A. All of the income on here other than those miscellaneous items of income are applicable to the production

of oil and gas and exploration and production activities, and all of that income is set forth within these columns.

Q. But does computation for the amount of net income attributable to crude oil sold to outsiders before entering your refinery?

A. No, it does not. Excuse me, would you read back?

(Question read)

A. Yes, it does.

Q. Where does it say that?

A. It is in these figures. It doesn't show it separately.

Q. You can't point to a figure that says exactly that, though?

A. No, I can't, except that all of it is from oil and gas, most of it.

Q. Could you give us a better method than that used by the auditor to determine that precise figure?

A. To determine the—

Q. The net income attributable to crude oil sold to outsiders before entering your refineries?

A. There are probably several different methods that you can use to—if you want to make a whole bunch of underlying assumptions—

Q. At the moment do you know of any better method than that used by the auditor?

Mr. Ragatz: I am going to object to this question on the basis that it isn't incumbent upon petitioner to say the correct, or a correct method of calculation. The petitioner only has the burden of showing that the method used by the respondent was arbitrary and violating the statutes. If counsel wants to ask our expert accounting witness, who will follow this witness, to develop such a method, I am sure our expert witness can do it. I don't think that is our responsibility, however.

Mr. Timken: Mr. Shapiro?

Mr. Shapiro: I have no further questions.

Mr. Timken: You are withdrawing that question.

Mr. Shapiro: No, no.

Mr. Timken: You have no further comments on that objection?

Mr. Shapiro: That's right.

Mr. Timken: So you want it answered if the Commission overrules the objection, is that correct?

Mr. Shapiro: Mr. Commissioner, I think the witness should answer that question. I submit that he should answer that question.

Mr. Timken: I agree he should if he can. This witness has testified at length on various methods, and I think the respondent is entitled to ask him that question, and if he can answer it, he should; if he cannot, he should say he cannot. The objection is overruled.

A. I think probably I could develop a better method, but not from the numbers that I have got here in this exhibit. I would have to go to other sources.

Q. But you have no better method in mind now?

A. I can't specifically tell you a method right now without going back and making an attack in that part of the formula, there is just a whole lot of underlying assumptions that maybe would not be relevant.

Mr. Shapiro: I have no further questions.

Mr. Timken: Re-direct, Mr. Ragatz?

Redirect Examination

By Mr. Ragatz:

Q. Mr. Koonce, in reviewing the method used by Mr. Sheridan to arrive at income from the sale of crude oil at the well head, did he or did he not use posted field prices as the value determined for these sales?

A. He did.

Q. And in intra company accounting for the value of the crude transferred from the E and P function to the Refining function, did you or did you not use posted field

prices as the value determined for the amount of crude oil transferred?

A. That's correct, for both purposes; that is sold at the lease and that is transferred to the refinery, it is the same.

Q. Then as far as sales to third parties are concerned, both your calculations internally for accounting purposes and Mr. Sheridan's calculations relied on the same basis?

(Last question read)

Mr. Shapiro: That certainly is a leading question, Mr. Examiner.

Mr. Timken: I don't think so; overruled.

A. We both used the same records, yes.

Mr. Ragatz: No further questions.

Mr. Timken: Any re-cross?

Mr. Shapiro: No, sir.

Mr. Timken: Mr. Koonce, you are excused.

The Witness: Thank you.

Mr. Timken: Mr. Ragatz, is your next witness going to be a lengthy one?

Mr. Ragatz: Yes.

Mr. Timken: Would you prefer that we waited until after lunch? It is a quarter to.

Mr. Ragatz: That's all right.

Mr. Timken: Mr. Shapiro, is that all right with you?

Mr. Shapiro: Yes, sir.

Mr. Timken: Very well, we will adjourn until 1:30.

(Noon recess)

Mr. Timken: Gentlemen, are we ready to go?

Mr. Shapiro: Yes, sir.

Mr. Timken: Mr. Ragatz, you may call your next witness.

Mr. Ragatz: The petitioner calls Ernest L. Wehner.

ERNEST L. WEHNER, called as a witness, having been first duly sworn, under oath, testified as follows:

Direct Examination

By Mr. Ragatz:

Q. State your full name, please.

A. Ernest L. Wehner.

Q. Where do you live?

A. In Houston, Texas.

Q. How old are you?

A. Fifty-four.

Q. Would you describe your academic background?

A. I graduated from high school in Del Rio, Texas, and attended the Texas A & M University and was graduated in 1941 with a B. S. Degree and Major in Accounting.

Q. Did you earn any honors in undergraduate school?

A. I graduated with honors from the Texas A & M University.

Q. Have you taken any postgraduate work?

A. Not specifically. I have been to several seminar—graduate seminar courses and I have taken some graduate courses in preparation for the certified public accountant's examination, but I have very little graduate work.

Q. Will you describe professional societies you belong to?

A. I am a member of the American Society of Certified Public Accountants, the Texas Society and Houston Chapter of Certified Public Accountants.

Q. Have you served in an officer's capacity in the societies?

A. Yes, I am a member of the Board of Directors for a number of years, both at the state level and local level.

Q. Have you written or participated in the publication of any books?

A. Yes, I have.

Q. I show you for the record a book entitled "Oil and Gas Federal Income Tax Manual, 9th Edition, 1966," and ask you about your participation in the preparation of that book.

A. Yes, I was the Chief Editor of that book.

Q. Is that a book put out by your firm?

A. Yes, it is.

Q. Have you participated in more than one edition of that book?

A. I have participated in the editorial work on about the last six editions of the book.

Q. And, I show you Exhibit 11-11 admitted into evidence in this proceeding and inside the front cover of that exhibit is a list of books that Mr. Kaspar referred to in connection with the audit he made of the Humble Oil and Refining Company.

Do you find your book on that list?

A. Yes, it is at the head of the list.

Mr. Ragatz: Let the record show that the witness is referring to the first book listed on that, which bears the name of the book just described in evidence.

Q. What is the circulation of that book, Mr. Wehner?

A. That printing was 20,000 copies.

Q. Are you a certified public accountant?

A. Yes, I am.

Q. How long have you been?

A. I was certified in 1947.

Q. Have you written any other books or papers or made any other presentations that you would like to note here?

A. I have been a speaker at many major tax seminars throughout the country; seminars such as at the Tulane Tax Institute, the University of Wichita Tax Institute, the University of West Virginia University, and the Uni-

versity of Texas, quite a number of the major tax institutes.

Q. Have you had any government service?

A. I have not had any specific government service as an employee, but in 1967 and 1968 I was one of the three certified public accountant members of the adversary group to the Commissioner of Internal Revenue in Washington, and on several occasions I have served as a Special Consultant to the Treasury Department; once in connection with matters pertaining to oil and gas income tax regulations, and once in another extenuous tax matter.

Q. Will you describe your employment history since graduation from college?

A. I was inducted into military service for five years immediately after I was graduated in 1941, and I started to work for Arthur Andersen & Company in its Houston office on May 1st, 1946, and I have been constantly employed in that office in Houston since that time.

Q. What is your present position with your firm?

A. I am the managing partner of the Houston office.

Q. What positions with the firm have you held prior to this present position?

A. Prior to the time that I was put in charge of the Houston office I had been, for many years, the head of the Tax Department, about the previous 10 years, and I also was in charge of all oil and gas taxation policy matters for the entire firm for a period of about 15 years preceding that.

Q. Would you just briefly describe the nature of Arthur Andersen & Company?

A. The firm of Arthur Andersen & Company is an international firm with about 100 offices in 34 countries in the world. It has about 13,500 employees and about 900 partners. It does a gross volume of business on the order of 300 million dollars.

Q. Do you hold any positions in management of that international firm itself?

A. I am a member of the Board of Directors of that firm.

Q. How large is that Board?

A. It has 12 elected members and three or four appointed members.

Q. Would you describe the Houston office of Arthur Andersen & Company that you manage?

A. Houston is the third largest office of the firm. It presently is composed of about 535 people, including 33 partners.

Q. Would you further describe your experience in the oil and gas industry with firms other than Humble Oil and Refining Company?

A. Starting with my first experience in the Houston office of Arthur Anderson & Company in 1946, I was initially engaged in doing work in the Audit Division and got some experience in auditing, and I later decided to specialize in taxation, and from that point forward I would say that I spent a large majority of my time in various phases of the oil and gas industry; much of that time being spent in the taxation side, but also in general accounting and management information systems and other services.

Q. Now, would you describe the experience that you had with other multi-functional oil and gas corporations?

A. Well, our firm in Houston are the auditors of a number of firms that were mentioned by Mr. Luper in this exhibit that he put on of the listing of some of the companies that had multi-functions, and others that have a limited number of functions, and we audit in Houston some of the largest and some of the smallest independents. We sort of cut across entire scope of the activities of the oil and gas industry.

Q. Would you also mention briefly any experience that you have had with other multi-state corporations besides oil and gas companies?

A. We have had experience, and I have been very close to a number of companies in the manufacturing business that cross state lines and have manufacturers in sales in multi-state activities. We have others that have principally distribution-type operations that cross state lines and service-type industries that cross state lines also.

Q. Going back to the oil and gas industry, would you describe some of the major companies with which you have experience, including the nature of their functional operations?

A. I will give you the names of some of these companies, but I will not be able to discuss very much of the work that I do for them because of the confidentiality of it, but there is the Texaco, Incorporated, which is on Mr. Luper's list, Esso and Skelly Oil, which is on Mr. Luper's list, and I am also very familiar with such companies as Tenneco and Pennzoil and Superior Oil Company, and a number of the larger multi-functional companies.

Q. Are these companies all operating in the three major functional areas of E and P, Refining and Marketing?

A. Not all of them. For example, the Superior Oil Company is principally in exploration and production.

Q. Have you had experience with other companies in the oil and gas industry that operate in less than all of the three major functions?

A. Yes.

Q. How long a period of time in total have you been involved in the oil and gas industry accounting capacity?

A. About 28 years.

Q. Would you describe your familiarity with the Exxon Company USA and its predecessor, the Humble Oil and Refining Company, prior to this case?

A. Yes, I have had an affiliation of one kind or another with work for the Exxon Corporation dating back to about 1958 or '59; rather limited, but at that time I personally review the federal income tax returns for the years 1958 and 1959 before they became a wholly-owned subsidiary of the Standard Oil Company of New Jersey, and I have consulted with them on various special projects from time to time and have reviewed certain information that I was preparing for technical papers and in the preparation of this book of which I was the editor and I have had quite a close contact with their Tax Department over the years.

Q. And did this exposure to the operation of Humble Oil and Refining Company include exposure during the years 1965 through 1968?

A. Yes, it did.

Q. Can you think of any particular projects or assignments that you had in connection with this company that might be germane to the present subject at issue?

A. In connection with my consulting with the Treasury Department in 1967 and 1968 I had several conferences with a number of the executive personnel of the Exxon Corporation with respect to some of the procedures that they had used for years in connection with oil and gas taxation.

Q. During this period was Arthur Andersen & Company the public accounting firm that audited Humble Oil and Refining Company or Standard Oil of New Jersey?

A. No, sir.

Q. What company was that?

A. Price Waterhouse were the auditors.

Q. Now drawing on your long experience in the oil and gas industry, would you please describe the utilization of posted field prices for accounting purposes?

A. Yes. As has been mentioned by previous witnesses, the posted field price is an available figure which gives you a figure at which crude is bought and sold in the market place and in various areas. And so in accounting we use that as the measure of profitability and sales value for various products. And it's also used very extensively in oil and gas taxation for both state and federal income tax purposes.

Q. Does this use include internal transfers of crude oil?

A. Yes, it does.

Q. Would you describe that to us?

A. Well, when a company is in a multi-function situation and owns its own production and also has refineries, in order to properly account for the performance of the various functions, they use a posted field price as the measure of value in transferring crude from the E and P Department into the refining function.

Q. Now during the years in issue in this case was this a well-accepted and widely-used practice in the industry?

A. Yes. Without exception I believe the oil companies used the posted field prices.

Q. And that's for internal transfers as well as sales to preferred parties?

A. Yes.

Q. Now what kind of a transfer price was used for natural gas?

A. For natural gas? Ordinarily there are two ways that you can determine fair market value of natural gas and that is by relating it to contracts that are to be effective at the well head and others where there is a market only for the gas at the tailgate of a natural gasoline plant.

Q. When you have gas with a price at the tailgate of the gas plant, how do you compute the well head price?

A. We use a backup formula which has been referred to by the prior witnesses as the Fiske formula. And that formula in effect takes the value of the gas at the tailgate of the plant and through eliminations of various items backs up the costs and values back to the well head.

Q. How did this formula get its name?

A. It was derived by a man who at that time was the Senior Review Engineer for the Internal Revenue Service in the Southwest Region at Dallas; and his name was Leland Fiske.

Q. Did you personally know him?

A. Yes, I did.

Q. During the years in issue, was this Fiske formula or equivalent back-up-calculation well accepted and widely used in the industry?

A. Yes, because of Mr. Fiske's senior position in the Internal Revenue Service and because of its practicality, it was very widely accepted for both federal and the state income tax purposes.

Q. Now would you describe the use of posted field prices as to crude oil and Fiske formula as to gas for depletion calculations?

A. Yes. The depletion is allowed on the value of the product at the well head; and that value must be determined as a fair market value in dealing in an arm's length basis where you are dealing with outside sales. Of course, that value becomes the value for depletion purposes and when there is no sale at the well head, the third-party equivalent is used. And in that case for crude the posted field price is used. And with respect to natural gas, in those years we used the Fiske formula to back into the value from the first-known price which was at the tailgate of the gas plant.

Q. Now does the Internal Revenue Service accept this as a proper measure of value?

A. Not only accepts it, they insist on it.

Q. Now would you describe the use of posted field prices and the Fiske formula in determining severance tax liability to the producing states?

A. Yes. The most of the producing states, the production and severance taxes are based on fair market value at the well head described similarly as to the depletion allowance. And the posted field price and the Fiske formula method of backup to well head gas prices are all accepted and used very widely for determination of those values for severance taxes.

Q. Which states impose a severance tax?

A. Texas, Louisiana, Oklahoma, New Mexico, I suppose, I know Colorado and probably California, I am not positive.

Q. And do these states accept the determination of value arrived at from posted field prices and the Fiske formula?

A. Yes, they do.

Q. Would you describe the use of the posted field prices and the Fiske formula-determined prices for income or franchise tax purposes in the producing states?

A. Well, as I mentioned, the determination of the income at the well head for all of these purposes is necessary particularly when you are allocating income to the various states; and the states have always followed fairly closely the federal rules with respect to determination of fair market value. So these states have also accepted the posted field prices and the Fiske formula-type calculation.

Q. And would you describe the use of the posted field prices and the Fiske formula in making determinations of values for royalty payment purposes or third-party working interest purposes?

A. Well, royalty contracts usually call for the royalty owner reserving a fraction of the fair market value of the

minerals as produced. And this, of course, is a factual determination and all settlements that I know of by purchasers or production are made on the basis of posted field price or the formula determination for natural gas at the well head using the Fiske formula.

By the same token, where you have joint interest owners in the working interest of leases, those settlements are always made between owners where one of the witnesses mentioned that in a typical oil and gas lease where there is more than one owner, one is appointed the operator and usually has the obligation of disposing of the producing on behalf of the others. And those settlements, the sales are generally made and the settlement is made on the basis of posted field price and also in connection with gas at the fair market value under the Fiske-type calculation.

Q. And based on your experience do the owners of the royalty interest and the owners of the working interest accept the values so determined?

A. Uniformly as far as I know.

Q. Would you describe briefly the Internal Revenue Code proportional profits theory on depletion?

A. Well, the proportional profits theory of depletion is generally applied to hard minerals and it allocates fair market value of a mineral product that is not sold at the mine on the basis of the expenditures which are made against it so that each dollar of expenditure proportionally applies to a fraction of the selling price in determining fair market value at the mine.

Q. Can you explain the reason for the proportional profits theory being used as to hard minerals?

A. There is no better method of determining fair market value at the mine than the proportional profits method that has been devised. And it is statutory with respect to hard minerals in the Internal Revenue Code.

Q. Now is this same method used in the oil and gas industry?

A. No, it is not.

Q. Would you explain that?

A. Well, it is not used because there are other sources of determining fair market value at the well head which are more reliable, easier to determine and achieve a more equitable result.

Q. And what are these other sources?

A. The posted field price and the formula-type calculation for natural gas.

Q. Now you have touched on this already but I would like you to describe a little more fully the application of posted field prices as to crude when the crude is put through the producer's refinery?

A. Well, as I said, in order to form a cost base for the products that are, or for the crude oil that is going into the refinery, to put the produced crude and the purchased crude pretty much on the same basis they need a determination. And it is good for accounting purposes to have a determination made of the value of that crude. And so all crude, whether it is purchased from royalty owners and outside mineral interest owners or sources even where the refiner does not have any ownership to put all of those on the same basis, the produced crude is valued at the posted field price going into the refinery.

Q. I believe you heard Mr. Carter's testimony yesterday as to the transfer prices of natural gas. Can you tell us from your experience whether the use of transfer prices based upon the determination described by Mr. Carter is consistent with good accounting principals?

A. Yes, I am very familiar with the transfer of products from the refinery into marketing; and although there might be some slight variation in the proprietary aspects

of the accounting, practically all of them use the determination from Platt's Oilgram or other public sources where fair market value can be determined.

Q. I think you may have misunderstood my question or anticipated me. I was really asking about the transfer level between E and P and Refining relating to Mr. Carter's testimony as to the determination of gas prices, and I will get to the other one in a minute, but can you tell us from your experience whether the use of transfer prices for gas based upon the determination described by Mr. Carter is consistent with good accounting principles?

A. Yes, I am sorry. I did not understand the question properly.

Q. Your answer is?

A. My answer is that it is consistent with good accounting. It involves the gas that is transferred from E and P to be used as a fuel source.

Q. All right. As long as we got into it, let me ask you the same question as to the transfer between the refining and marketing based upon the Platt's determined prices as described by Mr. Campbell in the evidence yesterday.

A. Yes. The question—the answer there is similar to the one that I made to the question that I misinterpreted. Here again, as I say, there might be some slight variation for proprietary reasons between the methods used, but practically every company with which I am familiar uses a source such as Platt's Oilgram, a published source to make, or to determine the transfer price from refining into marketing.

Q. Based upon your background in the industry and your extensive knowledge of oil and gas accounting, do you have an opinion as to whether or not for purposes of correctly and fairly determining the profits of an explora-

tion-production function, the use of posted field prices on transfers between E and P and Refining gives a result equivalent to a third-party sale price?

A. Yes, it is my opinion that the use of the posted field price and transfer price as determined from the Platt's Oilgram and other outside sources gives you the equivalent of a third-party price.

Q. Let me ask you if you want to correct that statement —that reference to Platt's Oilgram in terms of transfer between E and P and Refining. I find that the Fiske formula and Platt's sometimes get interchanged, and I would like to ask you whether you didn't mean the Fiske formula determination in that last statement?

A. Yes.

Q. Now based upon your experience, would you further describe your experience with multi-functional oil and gas companies having E and P, refining and marketing functions? I am particularly interested in the functional accounting that they do and whether they followed the policy that previous witnesses have referred to as "functional profitability independence?"

A. Yes. Do you want me to discuss that?

Q. Yes, discuss your experience with other companies' use of this policy?

A. It has been my experience that all companies use the functional profitability independence for measuring the performance of their various operations. They measure their performance of the E and P function by applying posted field prices and Fiske-type formulas to determine the values of the products and to measure the profitability and the success and operations of the personnel, and with respect to the other functions, the refining function, they measure the performance of that operation by having a net income determination by that particular function and

carry it over into marketing and each of the other functions, so that they use this for a number of purposes, probably the principal of which is to measure the performance of their personnel and their investments with respect to those functional operations.

Q. Now is this equally true as to companies that have only refining and marketing functions?

A. Yes, it is.

Q. Now would you comment on whether these functional departments in such companies are generally treated as separate businesses for internal accounting purposes?

A. Yes, they are.

Q. Now as to the individual functions themselves, based upon your experience do these separate functions have differing capital investment requirements?

A. Yes.

Q. Do they experience different returns on capital investments?

A. Yes.

Q. Now would a formula apportionment method which assumed a uniform return on capital investments be realistic to the facts in the industry?

A. No.

Q. Would a formula method that assumed a uniform net income as a percentage of dollar of sales be realistic as to the facts in the industry?

A. No.

Q. And do these companies with which you are experienced have the differing percentage net income for differing types of sales?

A. Yes.

Q Now in these companies are the individual functional departments treated as separate profit centers?

A. Yes.

Q. And separate investment centers?

A. Yes.

Q. Do the multi-functional companies you are experienced with use posted field prices for transfers?

A. Yes.

Q. Between E and P and Refining?

A. Yes.

Q. Do the companies in the industry utilize arms-length price determinations for transfer prices between their refining and marketing functions?

A. Yes.

Q. And how do they determine this transfer price generally?

A. How do they determine the transfer price between refining and marketing?

Q. Correct.

A. By use of extraneous sources of material, principally the Platt's Oilgram.

Q. As auditors of such companies, have you or your firm tested these transfer prices?

A. Yes, we have.

Q. Based upon your experience, do you have an opinion as to whether such transfer prices provide an accounting result equivalent to a third-party sale price?

A. It is my opinion that it does provide that.

Q. Is it or is it not your opinion that such prices can be considered as arms-length and fair and reliable for accounting purposes?

A. Yes.

Q. Now will you describe the theory and practice of functional profitability independence in the industry, and first of all in the E and P function by individual wells?

A. Yes. It has been stated by Mr. Koonce, I believe, that for the computation of depletion we have to arrive at

a net, net income by unit of property. That unit of property can take the form of either a well or several wells or in most cases not anything larger than a single oil and gas lease. There are also many types of drilling arrangements that a company will enter into which will make it necessary to account separately for the oil and gas net income from one well as related to other wells on a single lease, so I would say that within the industry it is practically universal that they are on accountability by wells. In some cases not all the way down to net income, but certainly with respect investment, with respect to growth income and some direct expenses.

Q. Is there also profit accountability by other segments, such as gathering groups of fields?

A. Yes, by combinations of the factors making up the net income on a specific well, income can be determined for statistical purposes, for example, to determine production from an oil and gas field, and in some instances as has been mentioned, there are several fields underlying a single geographic area, and it is necessary to account for those fields separately for many purposes and to determine the profitability of a district or a division, sometimes there is accountability for the district itself and for a division to compare one division against another.

Q. Now, would you further describe the theory and practice of functional profitability independence in the industry as to the net income derived from the E and P Functional Department itself?

A. When all of this information is consolidated and there are allocations made of expenses which apply, cost of the various functions, it is very easy to determine the functional profitability of the E and P function itself.

Q. Would you comment on the same line of inquiry as to the refining function?

A. Yes. Practically everyone who owns more than one refinery is going to keep a separate set of books with respect to each separate refinery operation. Refineries are not generally in clusters but are separate rather widely geographically, and so it makes for an easy determination of accounting by refineries, and then when you have a number of refineries making up the refining function, you can aggregate all of the information and make your appropriate allocations of items which cross functional lines and you can determine the functional profitability of the refining operation.

Q. Does this give you the net income derived from the refining functional departments?

A. Yes, it does.

Q. Would you comment on the same line of inquiry as to the marketing function?

A. Well, the marketing function is somewhat different from the other two in that you can start off your build-up of your functional profitability with such things as individual service stations. Most companies will have quite a lot of information specifically about a single service station, the investment in it, the volumes that are sold from that station of both the refined products and the packaged products, and tires, batteries and accessories and all of those things so that it is fairly easy to determine all of the accounting data with respect to the single stations themselves. Then as you aggregate within a district the various stations, you can come up with similar profitability information with respect to the district and expand onto the region and to the entire functional division of marketing.

Q. Does that include states too?

A. Yes, it does. I didn't mention that for state income tax purposes most companies that have multi-state operations will also have the segregation of the districts; for example, down into various state operations.

Q. Does this application of the functional profitability independence approach then allow you to arrive at net income derived from the Markting Functional Department?

A. Yes, that is a final result of the combination of all of these individual determinations.

Q. Now would you next describe the characteristics of functional unit accountability in terms of the results as to unrealized income derived from each unit?

A. As to unrealized income derived from each unit?

Q. Yes.

A. By use of the transfer price we determine, before there is a realized sale to an outside third party, the income which is derived from the function. For example, by crediting the E and P function with the posted field price of crude being transferred into the refinery, we can immediately determine the profitability without any further determination of what happens to the crude once it leaves the E and P operation.

The same is true with respect to crediting the refinery operation with a transfer price prior to the time that there is actually a sale made to a third party, so that the income is actually derived by the function, whether or not it is realized by sales to outside third parties.

Q. Is this an advance of the realization in some cases?

A. Yes, it is.

Q. Would you comment on the necessity to manage and generate realized income at the corporate level in light of the functional unit accountability discussion?

A. It is only when sales are made to outside third parties that there is actually an income realization and a cash-flow and a capital build-up for companies to discharge their corporate obligations and to have investment capital available for the decision as to how the capital should be employed at the corporate level.

Q. Now on the same subject will you describe the characteristics of the functional unit accountability as to the recognition of unrealized, derived income which would make possible situs and separate tax accountability?

A. As I mentioned previously with respect to the earnings to the exploration and production function, by crediting that function with the posted price of all crude that is discovered and produced in that function, we are not concerned with whether the profit is realized, but we know it has been derived because we have valued it at a price which is an arm's length basis on which it could have been moved in commerce outside of the company-owned refinery operation if it had been made available, so that we do not try at that point to measure the performance of the E and P function by realized income, but we have derived the income by arm's length bases.

Q. For what tax purposes is this necessary in the producing states?

A. Well, in the producing states ordinarily they are not concerned so much with the realization of profit as they are with the deriving of the profit at the well head for purposes of making the income determination and the depletion calculations and that sort of thing.

Q. Is this also necessary for those producing states that have income and franchise taxes?

A. Yes. I was speaking particularly of those states that have income and franchise taxes.

Q. And is the same kind of determination necessary for severance taxes?

A. Yes, it is.

Q. And I think you have already mentioned the royalty and the working interest.

A. The severance and the royalty and the outside interest operation regulations are incurred at the time the production is moved off of the lease regardless of whether

it is sold to an outside party or it is put into the company's system.

Q. As to that portion of the crude that's put into the company's system, the income is not realized at that point, is it?

A. That's right.

Q. But the states tax it at that point nevertheless?

A. Generally, that's true, yes.

Q. And recognize that it's derived at that point?

A. Yes.

Q. Would you further comment on characteristics of functional unit accountability and their application to permit management at the corporate level to deal with this concept of functional profitability independence or functional stand-alone policy determinations?

A. Well, as I said, the top management of the company, by utilizing functional profitability independence, can measure the operations and performance of the various functions against their own standards and they can also measure them against information which might be available from sources outside the company to measure that company against others. And this is true with respect to each of the functions. By determining the profitability of the refining operation they can compare with companies that have no function other than refining. It's both for an internal measurement of performance and it's also for the purposes of measuring competition among competitive businesses.

Q. Would you describe the work you have done to prepare yourself for your testimony in this case relating to the specific accounting practices of Humble during the year in issue?

A. Yes. I have, over the last two years, conferred on numerous occasions with most of the people who have appeared here in connection with this proceeding. I have

had several conferences with other executives of the company to determine for myself such things as the implementation of the company policies regarding posted field prices, Fiske formula-type calculations, Platt's Oilgram and that type of thing.

I have also taken the information with respect to the income tax returns and have compared them back to the books and records; and I have reviewed the computations that have been made, some of which have been submitted here as exhibits.

Q. What additional reviews did you make in connection with industry practices?

A. Within my own organization to recheck some of my thinking with people that work on a day-to-day basis with others of our clients, I have gone back and reviewed these matters to be sure that there was not something that I might be missing from my own personal experiences.

Q. Are you familiar with Humble's corporate structure and its functional operations?

A. Yes, I have.

Q. And have you heard or read the testimony to date at this hearing?

A. Yes, I have.

Q. Considering the oil and gas industry's accounting factors you have already mentioned and considering the internal accounting principles of multi-functional oil and gas companies you have also discussed, would you comment upon your review and tests of Humble's accounting and reporting procedures for the years 1965 through 1968?

A. Well, as I mentioned, I went back to the basic accounting information that was prepared by the Accounting Department to determine for myself whether I considered this to be the type of thing that was usual and customary to be found among businesses within the industry; and I found it to be that Humble does use a system

of accounting and its functional profitability independence is very similar to that which is found throughout the industry.

Humble is considered in many instances as a leader in this area and it has very reliable information.

Q. And could you describe a little more fully the nature of your review and your tests in arriving at that conclusion?

A. I spent quite a bit of time with Mr. Koonce who is very, very familiar and can answer your questions and lead you to the basic source data in the accounting records for answering your questions. And I had talked with the others about company policy and through him and going back to the accounting records I was able to assure myself that there was a lot of integrity in the use of this information throughout the accounting records of the company.

Q. And did this review specifically cover the internal accounting and transfer pricing procedures for the years in issue?

A. Yes, it did.

Q. Are you satisfied that Humble consistently used posted field prices for recording the transfer of crude from the E and P to Refining?

A. Yes, I am so satisfied.

Q. Are you satisfied that Humble used third-party contract prices or prices determined in connection with the Fiske or an equivalent formula for the transfer of gas to the Refining Department?

A. Yes.

Q. Are you satisfied that the company used Platt's or an equivalent calculation related to prices for the transfer from Refining to Marketing?

A. Yes.

Q. Would you comment upon your review and tests as to Humble's separate accounting returns filed in Wisconsin for the years 1965 through 1968?

A. Yes. I took those returns and went to the accounting data of the company from which it was prepared and checked on a line-by-line basis for all of those items that were accounted for separately with respect to the State of Wisconsin. And as has been mentioned before, there are certain items of expenses which have been allocated from the Midwest area and others like advertising that have other forms of allocation; and I checked the method of allocation of those expenses to the separate return and I have satisfied myself with respect to those returns that were prepared and filed.

Q. So I take it that that would include the fact that you were satisfied with the accounting for the Wisconsin sales and cost of sales?

A. Yes.

Q. And for the accounting for the direct recording of expenses?

A. Yes.

Q. Were you also satisfied that the expenses that were allocated, and I think those have been illustrated on an exhibit in this case—

A. Yes.

Q. —that these were allocated consistent with good accounting principles?

A. Most of those were allocated on the basis of the sales realization method.

Q. And are you satisfied and do you have an opinion as to whether or not the returns fairly reflect the results of Humble's Wisconsin operations on a basis consistent with generally accepted principles of accounting consistently applied?

A. Yes. It is my opinion that those returns on a separate accounting basis do properly reflect the operations of Humble in Wisconsin.

Q. Now would you comment upon your review and the tests you made of the State's audits of Humble which are in issue in this case?

A. I reviewed quite extensively the audit report of the examination performed for the years 1965 through 1968.

Q. And did your review reveal whether or not the State respected the integrity of Humble's internal determination of the net income derived from its E and P function?

A. Yes. There were several instances that could be checked back to the accounting records where the auditors used that functional net income for purposes of making their own calculations.

Q. Now based upon your broad experience in the oil and gas industry and upon your background and familiarity with Humble's operations during the years in issue and in reliance on the record in this case to date, do you have an accounting opinion considering the industry's accounting factors and the internal accounting principles of Humble's multi-functional operation as to whether, during the years in issue, Humble's operations conformed to accepted Internal Revenue Code state and industry external and internal accounting and tax reporting procedures in all respects?

A. There is excellent integrity in the accounting records of Humble Oil and Refining Company; and I personally believe that those records are entirely accurate for purposes of the Internal Revenue Code and for purposes of making accurate functional determinations of net income within the company.

Q. Do you further have an opinion as to whether Humble conformed to the internal accounting and transfer pricing procedures accepted by the industry to properly reflect the policy of functional profitability independence?

A. It is my opinion from my review that they can determine accurately that information.

Q. And, further, do you have an opinion as to whether Humble's accounting and reporting isolated and supported the identification of all net income, first of all, derived at the situs of production for the E and P function?

A. Yes.

Q. And, secondly, the net income derived at the point of operation for the refining function?

A. Yes.

Q. And, thirdly, the net income derived at the point of operation for the marketing function collectively?

A. Yes.

Q. And for the State of Wisconsin separately?

A. Aboslutely.

Q. And do you further have an opinion as to whether each of Humble's Wisconsin returns on a separate accounting basis were valid in terms of proper internal accounting principles consistently applied?

A. Yes.

Q. You have an opinion and your opinion is—

A. I have an opinion and my opinion is yes.

Q. Do you further have an opinion as to whether or not the net income derived by Humble's E and P function was in any accounting sense created even in part by business done in Wisconsin?

A. It is my opinion that there is no relationship in the net income of the E & P function and business done by Humble in the State of Wisconsin.

Q. Under generally accepted principles of accounting, was such income fully earned at the point where the oil and gas were available for this disposition by the E and P function?

A. Yes.

Q. Under generally-accepted principles of accounting, do the refining and marketing functions serve to increase or decrease the amount of Humble's production income?

A. They do not.

Q. Neither?

A. Neither.

Q. Do you have an opinion as to whether the present application by the State of its apportionment formula in effect produces Wisconsin taxable income by subjecting Humble's E and P and Refining net income to tax year in this state?

A. It is my opinion that the formula that was used in connection with this product does tax a portion of Humble's earnings and profits and net income.

Q. And do you have an opinion as to whether the application of the apportionment formula here is consistent with a good accounting practice in respect to using a second factor for the cost of manufacturing measured by the selling price of goods produced?

A. I would state that I have never encountered that type of a factor before, and it appears highly unusual that that type of a factor would be used in view of the statutory language which requires a three-part formula which does not include that type of hybrid formula that has been called throughout this hearing.

Q. Do you have any opinion as to whether the application of the apportionment formula is consistent with good accounting practice in weighting down the cost of manufacturing factor?

A. As I said, it is highly unusual and I haven't experienced it before and therefore I would have to state that it is unique and I don't really know that—I don't see how it applies in this case.

Q. Can you explain the impact of weighting down one factor of the three-factor formula in terms of how the result reflects the activities of that particular company in the State?

A. I will see if I understand the question. When you give weights to the various factors and you have factors which do not appear within a state, such as cost of manufacturing, you end up with figures that have very little relationship to the determination of the—or the application of the formula to the net income within the state.

Q. In other words, where there is no cost of manufacturing—

A. It should have no weight.

Q. And by excluding even part of it, you change—

A. You change the whole relationship of all of the other factors when you introduce something that isn't present.

Q. Now, do you have an opinion as to whether the application of the apportionment formula is consistent with good accounting practice where it employs the assumption that each dollar of investment produces an equivalent return?

A. Any formula that uses that assumption has to be questioned.

Q. And do you have an opinion on the same basis as to whether the employing the formula of the assumption that each dollar of sales produces an equivalent dollar of net income and thus our costs are uniform on sales?

A. That formula should also be examined.

Q. And do you further have an opinion as to whether these assumptions are consistent with the factual pattern in the industry?

A. It has been my experience that where a formula apportionment method is used that the formula has been applied as provided within the statutes.

Q. But based upon your experience does the industry reflect an equal dollar of net income for each dollar of sale?

A. No, I do not believe that it can be said that the industry would give that kind of a result.

Q. And does the industry experience indicate an equivalent dollar of return for every dollar of investment?

A. No.

Q. Now, based upon your experience do you have an opinion as to whether these two assumptions are consistent with Humble's factual situation?

A. Certainly not.

Mr. Timken: We will take a ten minute recess.

(Recess)

Mr. Ragatz: You may proceed.

(Question read: Now, based upon your experience do you have an opinion as to whether these two assumptions are consistent with Humble's factual situation?

A. Certainly not)

A. I would like to say that I do have an opinion and my opinion is that these assumptions do not apply to Humble Oil and Refining Company.

Q. I asked you several previous questions that were premised with the phrase "Do you have an opinion" and you may have given me a singular answer. Would you like to clarify on the record that you meant you had an opinion?

A. I do have an opinion in each of these instances.

Q. And your opinion was as indicated?

A. As indicated, yes.

Q. I am not sure whether I asked you whether you had an opinion as to whether the present application by the State of its apportionment formula in effect produces Wisconsin taxable income by subjecting Humble's E and P and Refining net income to tax year?

A. Yes, I did state that I believe that the formula which is used by the State of Wisconsin does tax a portion of Humble's E and P net income.

Q. Now do you have an opinion as to whether the apportionment formula as here applied produces a meaningful, reliable and reasonable result?

A. I do not believe it does achieve that result.

Q. Would you explain that answer?

A. Well, it was pointed out on some of the exhibits, the portion of the—the net income determination on a Wisconsin basis that is taxed under this formula is a much higher percentage than with respect to the total operations of the company, particularly in the marketing area.

Q. Now in that connection in light of your answer, would you comment upon what has been admitted into evidence as Exhibit 30?

A. Yes, Exhibit 30 is a summary for the four years that are involved in this proceeding of the factor attributes that—as they relate to the Wisconsin factors, and as pointed out by Mr. Koonce, the factors for the Exploration and Production Department contribute 22.6 percent and the income of the Exploration and Production Department on a Wisconsin basis is 74.4 percent, and to me that type of a distortion gives rise to a question whether or not the application of the formula produces a reasonable result.

Q. Would you have an opinion as to whether the application of the formula that produces that kind of variance between the factors attributes and the percent of income could produce a reasonable result?

A. It hasn't in this case and I don't see how it could, no, sir.

Q. Now would you comment on the mechanical steps involved in the State's formula where ratios are mutiplied by ratios? I believe Mr. Koonce pointed out in his testimony—

A. Yes, there are several instances in which the formula as it is used applies a ratio to a ratio, and where ratios are used you are in effect using averages or using estimates, and when you apply one against the other you compound the possibility that a result will be achieved

which is not reasonable, and when you start using ratios on ratios it is my opinion that the end result must be tested against that formula application to see that a reasonable result is obtained.

Q. Now then, do you have an opinion as to whether a formula as applied produced the result which shows Wisconsin taxable income in a reasonable relationship to Wisconsin activities?

A. I would like to refer to Exhibit 29 in which it shows that the Wisconsin taxable income pertaining to—or in relation to Wisconsin sales is 7.5 percent, whereas on an industry-wide basis computed on a Wisconsin basis, it is only 3.2 percent.

Q. You mean a Humble total marketing basis?

A. Humble total marketing basis, yes.

Q. Do you have an opinion as to the relationship of those two percentages in light of my question as to whether the result of the formula shows that Wisconsin taxable income in a reasonable relationship to Wisconsin activities?

A. I believe to me it appears that Wisconsin is reaching out to tax income which is not appropriately related to the State of Wisconsin.

Q. I would like to refer to Exhibit 28, Schedule A, which I believe is in front of you?

A. Yes, sir.

Q. And I would ask you just generally to comment upon the comparison between the taxable income assessed by the State's apportionment method and the separate accounting results reported by Humble in light of the question I previously posed as to whether the formula produces a result in any proportion to the—or in any reasonable relationship to the activities in the State of Wisconsin?

A. Well, as I stated previously, I had examined Humble's separate accounting and I have checked the accuracy of that reporting information back into the books and

records, and the aggregate of the losses reported for the four years involved on a separate accounting basis is approximately four million dollars, and the taxable income in the audit report is 4.5 million dollars, so the difference between the use of the apportionment method as applied by the State of Wisconsin and the separate accounting method is 8.5 million dollars approximately, and to me that is a grossly inequitable result.

Q. Do you have an opinion then as to whether or not that result is way out of proportion to the Wisconsin activities of Humble?

A. In my opinion it is way out of proportion to the Humble activities in the State of Wisconsin.

Q. In the process of your review of Humble and its policies, did you find any evidence whatsoever that Humble shifted profits between its functions during the years in issue?

A. No, I did not. Based on the work that I did, I would consider that there is complete integrity in the accounting records of the company.

Q. No further questions.

Mr. Timken: Mr. Shapiro, you may cross examine. Would you like a break?

Mr. Shapiro: Thank you. I think I will proceed and we may ask for a little break.

Mr. Timken: Very fine. You may proceed.

Cross-Examination

By Mr. Shapiro:

Q. Mr. Wehner, what formal training or experience have you had in the application and apportionment of State income or franchise taxes?

A. Formal training?

Q. Or experience, yes, sir.

A. I have had approximately 28 years of experience in working with taxation, much of which has been in multi-

state operations. Now as you well know, the State of Texas does not itself have an income tax return, but many of our clients in Houston do business which crosses state lines and have done so for practically all of these 28 years and most of my experience has been devoted to the area of taxation.

Q. Has your experience been devoted to the area of the —to the specific area of the allocation and apportionment of state income and franchise taxes?

A. Yes. I will say I have had considerable experience in that area.

Q. Isn't it true that accounting for tax purposes for— for state income tax purposes is quite a different matter than accounting for financial and management purposes?

A. That is true.

Q. Isn't it true that for overall apportionment purposes, functional accounting is not relevant but that the overall net profit is the significant figure?

A. I don't think I am qualified to answer that question.

Q. You testified regarding Exhibit 29, and that is a comparison, and do you have that before you?

A. Yes, sir, I have it in front of me.

Q. I believe the gist of your testimony was that that is a valid comparison as set forth on that exhibit. I would like to ask you if we used the 7.5 percent for percent of net income for dollar of sales comparing Wisconsin sales and Wisconsin assessed taxable income—

A. Yes.

Q. —and then over toward the right instead of the three columns on the right, we would use total company sales as compared with total company net income, and then get a percentage, and would that represent a valid comparison?

A. It would represent one means of testing the reasonableness of the application of the formula.

Mr. Shapiro: I will renew my request for five minutes.

Mr. Timken: You may have five minutes.

(Recess)

Mr. Timken: Mr. Shapiro, are you ready to proceed?

Mr. Shapiro: Yes, sir.

By Mr. Shapiro:

Q. Mr. Wehner, you also commented, I believe, on Exhibit 30?

A. Yes, sir.

Q. Is it not true that the thrust of the data in Exhibit 30 is based on a functionalized accounting system as is indicated by the breakdowns on the succeeding pages?

A. That the thrust of it is based on a functional accounting?

Q. Yes, that the import of this exhibit is based on functional accounting?

A. The underlying information that makes up the summary on the face of Exhibit 30 is based on functional accounting, yes, sir.

Q. Yes. Now I believe you also testified that you have had experience in apportionment and allocation of state income taxes?

A. Yes.

Q. How would you define a unitary business?

A. A unitary business is, in my opinion, a series of business operations which are so related that they are completely independent and contributory to each other in the final business operation.

Mr. Shapiro: I have no further questions.

Mr. Timken: Mr. Ragatz, any redirect?

Mr. Ragatz: Briefly.

Redirect Examination

By Mr. Ragatz:

Q. On Exhibit 29 Mr. Shapiro asked you to compare the 7.5 per cent return on Wisconsin sales per the Wisconsin audit within concept the total company's operations and its total net income. Do you have an opinion as to whether such a comparison would be a comparison which might be characterized as apples and oranges?

A. Well, not having seen such a comparison and not having it in front of me, it's difficult. But where we have Wisconsin with solely a marketing operation and the company having a very functional operation in total, I do believe that it would not be a valid comparison overall.

Q. Now referring to Exhibit 30 and also Exhibit 29, could you describe the impact on one dollar of net income in terms of the percentages shown on Exhibit 30 and compare it to the 7.5 per cent shown on Exhibit 29?

A. Well, as Mr. Koonce pointed out, the application of the factor attributes for the State of Wisconsin, that if they drew in one dollar of income it would draw in 74 cents of income from the Exploration and Production Department, 14 cents from the Marketing Department, 7 cents from the Refining Department and roughly 4 cents from other departments.

And when you look over and see that on Exhibit 29 and know that Wisconsin is purely a marketing operation, you can see that the comparison of the 7.5 per cent to the 3.2 per cent is a result of their formula attaching a large segment of the Exploration and Production Department's net income.

Q. One final question. When Mr. Shapiro asked you to define a unitary business, I wasn't sure whether you said interdependent or independent; do you recall?

A. I don't think I used the word.

Mr. Ragatz: Would you want to read back his testimony on that?

(Answer read as follows: Answer. A unitary business is, in my opinion, a series of business operations which are so related that they are completely in-

dependent and contributory to each other in the final business operation.)

The Witness: I thought I said that they are so dependent on each other. I am sorry.

Q. That's what you meant?

A. Yes.

Mr. Ragatz: No further questions.

Mr. Timken: Mr. Shapiro?

Mr. Shapiro: No further questions.

Mr. Timken: Thank you, sir. You are relieved.

(Witness excused)

Mr. Timken: Mr. Ragatz?

Mr. Ragatz: At this time I find myself in the pleasant position of being ahead of schedule and I didn't have my next witness scheduled to be in court until tomorrow morning. So I would be happy to agree to have Mr. Shapiro commence with his case, if that's agreeable to him, or to wait until tomorrow morning when I can put my other witness on, whatever the Commission's pleasure is.

Mr. Timken: I should inform you, Gentlemen, that this Commission, in anticipating that we may not be done this week, arrived at the decision that if we are not done by Friday we intend to schedule Saturday. The alternative is to carry over two or three weeks because we don't have any place to fit in the postponement. And I point that out to you gentlemen so that you can take that into consideration in this discussion now.

Is that your last witness, Mr. Ragatz?

Mr. Ragatz: We have one more witness and, as I say, that will be the first witness that I have tomorrow morning.

Mr. Timken: So do you prefer to adjourn until tomorrow morning or would you prefer to start your case now?

Mr. Shapiro: Well, if I could have about 10 minutes I would just as soon go ahead.

Mr. Timken: Sure. We will take a 10-minute break.

(Recess taken at 3:07 p.m.)

Mr. Timken: Gentlemen, are you ready to proceed? Mr. Shapiro, before we recessed Mr. Ragatz indicated that his next and final witness would not be here today, but he will be here in the morning and he offered you the opportunity to put in your case, or at least call one witness today. Are you willing to do that?

Mr. Shapiro: Yes, sir.

Mr. Timken: Very well, you may call your first witness.

Mr. Shapiro: The respondent will call Kurt Kaspar.

KURT KASPAR, recalled as a witness, having been previously duly sworn under oath, testified as follows:

Direct Examination

By Mr. Shapiro:

Q. You have previously testified as to your employment, Mr. Kaspar, and I would like to ask you whether you are a certified public accountant?

A. Yes, I am.

Q. And how long have you been a certified public accountant?

A. Since 1970.

Q. In connection with your audit of Humble, did you have one or more staff conferences in connection with the audit?

A. Yes.

Q. And where were those conferences held?

A. At our corporation offices in Madison.

Q. And at such conferences there were other representatives of the Department present, is that true?

A. Yes.

Q. And did you consider at such conferences whether Humble was—did you consider the question of whether Humble was a unitary business?

A. Yes, we did.

Q. And did you consider that question carefully?

A. Yes.

Q. Who is Arthur Barber?

A. He is the recently retired Chief Counsel of the Legal Staff of the Wisconsin Department of Revenue.

Q. Did he participate in one or more of such conferences?

A. Yes, he did.

Q. Did he advise that Humble was a unitary—

Mr. Ragatz: Objection. Hearsay.

Mr. Timken: Sustained. Hearsay.

By Mr. Shapiro:

Q. Do your conference notes disclose the fact that Mr. Barber advised Humble was a unitary business?

A. Yes, they do.

Mr. Ragatz: Objection. There is no foundation for the conference notes.

Mr. Timken: Sustained.

Mr. Shapiro: The conference notes are in evidence.

Mr. Ragatz: If the conference notes are in evidence, maybe they speak for themselves except as to relevance, but if you are going to ask the witness to characterize something, you are going to lay a foundation.

Mr. Timken: I think the objection was as to a foundation, was it not?

Mr. Ragatz: That's right.

Mr. Timken: Perhaps you can lay a foundation, Mr. Shapiro.

By Mr. Shapiro:

Q. I show you what has been marked as Exhibit 11-9, and this exhibit has been stipulated to as part of the record in this case, and I direct your attention to the first page therein. Can you identify that?

A. Yes. These are notes from the conference—the staff conference held upon my return from Houston where I did

the field work on the audit of Humble Oil and Refining Company.

Q. And did you prepare—is this your writing and did you prepare these notes?

A. Yes, it is my writing and I did prepare those notes.

Q. I read from these notes that you state, "Art feels there is no question but that Humble is a unitary business and that its Wisconsin operation is an integral part of that business." How did you come to write that down in your notes?

A. We had had a lengthy meeting and we talked about my audit and what I had learned while I was in Houston or what I learned subsequent to the return, and we discussed those elements and after a thorough discussion by everyone present, that conclusion came about.

Q. And at your discovery deposition did you characterize Mr. Barber as a recognized authority in the field of state allocation and apportionment of state income taxes?

A. Yes, I did.

Q. And is that your present assessment of him?

A. Yes, it is.

Q. I show you what is marked as Exhibit 11-11 and it is the Kaspar paper that has been previously referred to on several occasions. On pages 1 and 2 of this paper you make the statement that "These posted field prices are circulated by all large buyers and are bona fide competitive prices, not subject to manipulation or rigging and are effectively priced by states, regulatory agencies." Do you accept that statement as a fact now?

A. No, I do not.

Q. I refer you to Page 14 of the same paper where you state that, "As discussed previously, however, income from the sale of produced oil and gas generates non-apportionable income to the extent such oil and gas is sold to outsiders before entering the refining process."

Farther down on the same page, "To the extent that products of the farms, mines or quarries do not enter the unitary operation (in other words are sold in the same state as they are in when produced), the net income generated therefrom follows the situs of the property from which derived pursuant to Section 71.07(1) of the statutes."

Were you able to obtain directly from Humble's records the amount of net income generated from sales of produced crude oil to outsiders?

A. No, I was not.

Q. Why not?

A. They told me they did not have the information.

Q. In the absence of such information was a computation made utilizing Humble's E and P net income figure?

A. Yes.

Q. In the course of your audit of Humble did you ask for copies of exchange agreements?

A. Yes, I did.

Q. What was the response that you received?

A. It was in letter form from a member of Humble Oil and Refining Company.

Q. I would like to show that you are now looking at Exhibit 11-3. Can you identify that exhibit?

A. This contains Sections D and E of my work papers covering the audit of Humble Oil and Refining Company for the years 1960 through 1964.

Q. Do you find the response that you received in regard to your request for copies of exchange agreements?

A. Yes. This is a letter from a Mr. F. A. Ranzau, dated July 15, 1966 addressed to me. And he says, Dear Kurt: The following letter is submitted in accordance with your telephone conversation with Fred Heidner on July 7, 1966. Item 1. Exchange agreements. This matter has been discussed with our Marketing management and they

feel that agreements Humble has with outsiders to be supplied with products or to supply them with products are of a highly confidential nature. They are therefore reluctant to release copies of any such agreements.

(Exhibits 32 and 33 marked for identification)

Q. I show you what has been marked as Exhibits 32 and 33 and ask you to identify those exhibits.

A. These are examples of the barrel formula.

Q. First with respect to Exhibit 32 would you read the title?

A. Example of Barrel Formula.

Q. And Exhibit 33 is entitled?

A. Alternate Computation of Barrel Formula.

Q. Now did you prepare both of these exhibits?

A. Yes, I did.

Q. Now turning first to Exhibit 33 I would like to ask you, first, are exactly the same figures or data used in both exhibits?

A. Yes.

Q. Turning to Exhibit 33 can you describe step-by-step what you purport to show in that exhibit?

A. Exhibit 33 is designed to show another manner of arriving at the same result as to the formula used in the Humble audit. And I believe it's a simpler version of the basic barrel formula and is somewhat easier to follow. It's different from the basic formula only in that it doesn't attempt to break down the computation by department. It lumps the whole computation in one sequence of numbers which are more easily followed.

Line A gives us the total barrels of produced crude oil in this example by a company and that line shows 100 barrels. Line B subtracts the number of barrels sold by that company at the lease and that number is 25 leaving Line C which equals 75 barrels of crude oil transferred to the Supply Department.

In the Supply Department 105 barrels of crude oil were purchased; and that's shown on Line D. Line E shows then the total barrels available, total barrels of crude oil available to the Supply Department.

Line F then is the per cent of barrels produced by this company, barrels of crude oil produced by this company to the total barrels of crude oil available to the Supply Department.

I should clarify that somewhat. Line F shows the per cent of barrels of produced crude in the Supply Department after transfer from the E and P Department to the total barrels of crude available to the Supply Department. In this example that comes out to 41.6 per cent.

Line G is the total barrels of crude oil sold by the Supply Department and 60 barrels were sold. Line H is the barrels of produced crude oil sold by the Supply Department and that is a derived figure; and the example shows that 25 barrels of crude oil produced by this company transferred to the Supply Department were sold by the Supply Department.

And that figure of 25 is derived by multiplying 60 times 41.6 per cent. Now I think if you actually make that computation since 41.6 per cent isn't carried out to too many digits, you will not hit 25 exactly but it will be 25.999.

Line I then gives us the total barrels of the company's own produced crude that was sold and it's arrived at by adding Lines B and Line H, 50 barrels of crude of this company's own crude are computed to have been sold before entering the refining process.

Line J then is the per cent of crude oil produced that was sold and is merely Line I divided by Line A or 50 divided by the total barrels that were originally produced by this company which is a hundred.

Q. I believe you referred to a number 25.99 and so forth. Did you intend that to be 24?

A. 24.99.

Q. Now what amounts are predetermined, fixed amounts in this calculation?

A. Line A is a given figure, total barrels produced by the company. Line D, barrels purchased, is a given figure, known figure. And Line G, total barrels sold by the Supply Department is a known figure.

Now also Line B is a known figure, the barrels sold at the lease. So that in this computation it is only necessary to compute the amount of the company's own produced crude that was run into the pipeline commingled with other crude where one barrel could not be separated and separately identified from another. It is necessary to compute the amount, the portion of crude that was sold off by the Supply Department that was produced by this company.

Q. Did you specify that Line B is a known figure?

A. Yes.

Q. You did; is it?

A. Yes. At least we were told that was known. A company will generally be able to supply you with that figure.

Now this example is intended to show that it arrives at the same result as a basic barrel formula that was used in the audit of Humble and which contains a multiplication of a ratio times a ratio which has been objected to and which, admittedly, becomes confusing at first glance if you aren't able to look at it in this manner.

Q. In your alternate computation do you take a ratio over a ratio?

A. No.

Q. Did you state that Exhibit 32 represents the barrel formula set forth in your paper?

A. Yes, it does.

Q. And used in the audit?

A. And used in the audit and used in my audit of Humble for the years 1960 to '64. And I believe it was used in the subsequent audit.

Q. The results are exactly the same in both exhibits, is that correct?

A. Yes.

Mr. Shapiro: The respondent would move the admission into evidence of Exhibits 32 and 33.

Mr. Timken: Mr. Ragatz?

Mr. Ragatz: Well, I suppose to be consistent with Mr. Shapiro I should object to the admission of these exhibits because I assume they support his theory. If Exhibit 32 is supposed to be what the barrel formula did, then I guess that ought to be admitted on the same basis that our hybrid formula exhibit should be admitted. If Exhibit 33 is not what they did, then I am not sure that I see the relevance of that exhibit.

Mr. Timken: Exhibits 32 and 33 are received.

Mr. Shapiro: I have no further questions at this time.

Mr. Timken: Mr. Ragatz, you may cross-examine.

Mr. Ragatz: If I might have five minutes.

(Short recess taken at 3:43 p.m.)

Mr. Timken: Mr. Ragatz, you may cross-examine.

Cross-Examination

By Mr. Ragatz:

Q. Mr. Kaspar, you indicated that you were refused the exchange agreements you requested.

A. No, I don't think I said that. I just read the letter that was returned to me.

Q. Now have you got that letter in front of you?

A. Yes. They say that in conclusion they are therefore reluctant to release copies of such agreements.

Q. They didn't refuse to give them to you?

A. No, they didn't.

Q. Did you follow up and renew the request?

A. Not by letter obviously, and I don't find any comment in my notes that I did, so I can't answer positively. I think probably I did not.

Q. So you didn't insist on the exchange agreements, did you?

A. No, we did not.

Q. Are you aware of any other request for a copy of an exchange agreement prior to the request that was made at this proceeding on last Friday between the time of that letter you just referred to and now?

A. Cf any other request—

Q. For a copy of an exchange agreement—

A. —between the time of this letter and now?

Q. Other than the request that was made last Friday as part of this proceeding?

A. We may have discussed that at the time of some of our conferences with the Humble people.

Q. Do you have any notes that would indicate that you had requested—

A. No, I had—I would think we would have because that was a very important document, one that I am sure I asked for while I was at Humble, one that I followed up with then as part of this request.

Q. But you agree you didn't insist on it?

A. I did not.

Q. And I take it—

A. As far as insisting, we could always go the route of subpoenaing that type of record.

Q. But you didn't?

A. We did not do that.

Q. And I take it that a fair statement would be that you are aware of no place in your work papers which would

indicate that you made a subsequent request for an exchange agreement?

A. That's right.

Q. Now looking at your Exhibits 32 and 33, isn't it a fact that the barrel formula makes a number of assumptions?

A. It makes one.

Q. What is that assumption?

A. That crude oil is commingled once it enters the pipeline and that one barrel of crude cannot be distinguished from another. That, I understand though, is not an assumption from all of the testimony I have heard. Everyone has asserted to the same fact.

Q. Are you aware of any other assumptions made by this—

A. No, I am not.

Q. Isn't it a fact that this formula is really an oversimplification of the facts?

A. I don't know what you mean. It attempts to arrive at an answer.

Q. Where does the formula take into consideration the other interests in each barrel of oil?

A. On Line—in the "Purchased From Others" line. I assume the purchase of other interests are included in that line as purchased crude.

Q. You assume they are or they are?

A. They should be.

Q. How about the interest of the royalty owner in the oil? Where does that show up in this formula?

A. Well, as I just explained, it could well be in barrels purchased.

Q. It could be? How about the interest—the interest of the working interest owner?

A. All purchasers, regardless, from the interest or the other source, should be in the barrels purchased.

Q. You say it should be?

A. And of course we anticipate—

Q. Doesn't this formula make the assumption that an equivalent percentage of what was available is related to what is sold off? Maybe I can ask that a little more clearly.

Look at Exhibit 33. You have a net 75 barrels of produced oil transferred to the Supply Department.

A. That's correct.

Q. And total barrels sold off by the Supply Department were 60?

A. That's correct.

Q. Now it could be that all of those were produced barrels?

A. Certainly.

Q. And it could be that none of them were?

A. Yes.

Q. So you are making the assumption that it is prorated between purchased and produced in proportion to the quantities of each?

A. Yes.

Q. But that is just an assumption?

A. That is an assumption because we were unable to obtain any better information from the company. We were forced into that assumption.

Q. And you agree that the actual barrel formula calculation that you made does use the mechanical device of multiplying a ratio by a ratio?

A. Yes.

Q. Now would you also agree that the test of any formula approach would be a comparison with an answer produced by other reliable data?

A. I would think that certainly would follow.

Q. No further questions.

Mr. Timken: Any redirect, Mr. Shapiro?

Mr. Shapiro: I have one question.

Redirect Examination

By Mr. Shapiro:

Q. How did you obtain the data, the figures used in the formula?

A. Which formula?

Q. The actual formula used in your audit, how did you obtain the figues?

A. Directly from Humble.

Q. Do you know from whom you obtained them?

A. From members of the Tax Department, Mr. Heidner, who was at that time the head of the State Tax Department, and I also corresponded and dealt with his superior who I believe was Mr. Ranzau, who was a coordinator of the Tax Department, as I understand it.

Q. And when those figures were obtained had you spelled out the descriptions similar to those contained here as to just what figures you wanted?

A. Yes, very much. We discussed that at length many times.

Q. I have no further questions.

Mr. Timken: Anything further, Mr. Ragatz, of this witness.

Recross-Examination

By Mr. Ragatz:

Q. Which figures are you talking about?

A. Well, I understand he is talking about the audit itself, and the audit of Humble, and the numbers we used in the barrel formula and the computation of the nonapportionable percent of the E and P Department.

Q. You know, there are hundreds of figures in that audit. Which ones are you talking about?

A. All of the factual figures—all of the facts that we used in our formula were, of course, obtained directly from Humble.

Q. No further questions.

Mr. Timken: Mr. Kaspar, you may step down. Thank you.

Mr. Shapiro, you may call your next witness.

Mr. Shapiro: We call Carl Hoel.

CARL HOEL, recalled as a witness, having been previously sworn under oath, testified as follows:

(Exhibits 34 and 35 marked for identification)

Direct Examination

By Mr. Shapiro:

Q. Mr. Hoel, in previous testimony in this hearing your employment has been made a part of the record?

A. Yes.

Q. And I believe you testified that you are a certified public accountant?

A. Yes.

Q. And how long have you been a certified public accountant?

A. Since December of 1949.

Q. Now you are aware, are you not that the cost of manufacturing factor was weighted in this case?

A. Yes.

Q. Has the Department made a practice over the years of weighting the cost of manufacturing factor in certain apportionment cases?

A. Yes, it has.

Q. For how long a period, in your knowledge?

A. I believe it goes back at least to 1932.

Q. What is your testimony as to whether the Department relies on any statutory authority for weighting the cost of manufacturing factor?

A. I believe it relies on Section 71.07(3), which gives the Department the authority to elminate any particular factor if it is not material to the production of income in the particular taxpayer's operation.

Q. Does the weighting occur in cases in which a manufacturing and selling corporation does not manufacture everything that it sells?

A. Yes.

Q. Would you state briefly what we seek to accomplish by the weighting process?

A. Well, if a company manufactures part of the goods it sells, and purchases others, the one factor should not receive the full importance of the other two factors, so if it manufactures half of what it sells, the factors should only receive 50 percent weight.

Q. Does the weight of the cost of manufacturing factor ever result in reducing the Wisconsin net income below what it would be if that factor were not weighted?

A. Yes, it does.

Q. Are you acquainted with instances in which the weighting has been detrimental to the State from a revenue standpoint insofar as reducing the otherwise net taxable income?

Mr. Ragatz: I am going to object to the witness answering the question unless they are prepared to identify the company and the records to back it up.

Mr. Timken: Wait a minute.

Mr. Ragatz: They can't have their cake and eat it too; they can't keep us away from records to compare and enable us to examine other witnesses and other practices with other companies and then try to put in that same kind of information as part of their affirmative case.

Mr. Timken: Mr. Shapiro?

Mr. Shapiro: I will rephrase the question to, well, in this way:

By Mr. Shapiro:

Q. Isn't it a long-standing practice of the Department to use weighting in instances where the tax may be lower than if weighting were not used?

Mr. Ragatz: Same objection.

Mr. Timken: Do you want to be heard on that objection?

Mr. Shapiro: I will withdraw the question.

Q. Does weighting occur only in cases involving corporations doing business within and without Wisconsin?

A. Yes.

Mr. Timken: Mr. Hoel has requested a break. Does anybody have any objection? We will take a break if that is all right with counsel. Just a pause, though. Let's not leave the room.

Are we all set?

Mr. Shapiro: Yes.

Mr. Timken: You may proceed.

By Mr. Shapiro:

Q. Does the weighting occur only in apportionment cases?

A. Yes.

Q. Could you indicate to the Commission what determines in the weighting process in which the cost of manufacturing factor is weighted whether the Wisconsin income would be increased or decreased over what it would have been were the factor not weighted?

Mr. Ragatz: Could I have that question read back?

Mr. Timken: Read the question back, please.

(Question read)

Mr. Ragatz: Maybe I can just inquire, are you talking hypothetically or are you talking in actual situations?

Mr. Shapiro: I am talking about, we can clarify it with the example, Exhibit 34. And I think we will bring it out very clearly there. I will reserve it.

Mr. Ragatz: I guess I just don't understand the question.

Mr. Shapiro: I will reserve until the exhibit.

By Mr. Shapiro:

Q. Do you have Exhibit 34 with you?

A. Yes.

Q. Will you identify what that exhibit is?

A. This exhibit demonstrates the result achieved by weighting the cost of manufacturing factor.

Q. Did you prepare it?

A. Yes.

Q. What does it purport to show?

A. It shows the effect of weighting in two different examples, the first of which assumes that a corporation is engaged in manufacturing and selling but manufactures only 60 per cent of the product it sells and buys the other 40 per cent. And it further assumes that the apportionment factors are as set forth below: a sales factor of five-tents of a per cent, property factor of six-tenths of one per cent and manufacturing, zero per cent.

Now in this example if the cost of manufacturing is given full weight in the apportionment formula, the Wisconsin taxable income would be $780,700 assuming a total company income of 211 million dollars.

Q. Now if the cost of manufacturing factor were given away to 6 per cent rather than full weight on the theory that it was a factor in producing 60 per cent of the product sold, the Wisconsin taxable income would be $886,200 assuming the same total company income. Now on that example the manufacturing factor is given a weight of six-tenths rather than one.

Q. So that from this Example 1 does weighting, the cost of manufacturing factor, result in a higher, a larger net income, net taxable income on these assumed figures?

A. Yes, it does.

Q. Now in this instance the cost of manufacturing factor is lower than either one of the other factors, isn't that true?

A. Yes.

Q. Now moving to Example 2 what does that purport to show?

A. This example makes the same assumptions that the company manufactures 60 per cent of the product sold but it assumes that the manufacturing factor is 1 per cent and the sales and property factors are .5 per cent and .6 per cent respectively.

In other words, the manufacturing factor is larger than the average of the other two. Weighting, the cost of manufacture in this example, would show Wisconsin income without weighting the cost of manufacturing of $1,477,000. Now by weighting that cost of manufacturing giving it a weight of six-tenths of one rather than one, the Wisconsin income would be $1,371,500 or less than the figure given by giving equal weight to the factors.

Q. So that the determining factor as to whether weighting will result in a lower taxable income is whether the cost of manufacturing percentage is more or less than the other two factors?

A. Yes, than the average of the other two factors.

Q. Yes. In this instance where the net income is lower as the result of weighting, the cost of manufacturing percentage is 1 per cent whereas the sales and property percentages are less than 1 per cent?

A. That's right.

Q. Well, in the previous example where weighting resulted in a higher net income, the cost of manufacturing percentage was zero and lower than the sales for property percentage factors?

A. Yes.

Q. Now I would like to call your attention to Exhibit 35. Did you prepare Exhibit 35, Mr. Hoel?

A. Yes, I did.

Q. And what does Exhibit 35 purport to show?

A. This shows a comparison of the net income of the total company with assessed income from Wisconsin's operation showing the Wisconsin income for each of the years 1965 through 1968 as a percentage of Wisconsin sales; and the last three columns showed the percentage of the total company net income on the Wisconsin basis with total company sales.

Q. And how do the percentages compare?

A. Well, for the year 1965 the Wisconsin assessed taxable income to Wisconsin sales is 5.9 per cent and the total company ratio on the same basis is 11.6 per cent.

For 1966 Wisconsin is 7.3 per cent, total company is 13.5 per cent. 1967, Wisconsin is 7.7 per cent and total company is 14.6 per cent. 1968, Wisconsin is 8.9 per cent, total company is 15.3 per cent.

The totals for the four-year period shows Wisconsin as 7.5 per cent and total company is 13.8 per cent.

Mr. Shapiro: The respondent will, as this time, move the admission into evidence of Exhibits 34 and 35.

Mr. Timken: Mr. Ragatz?

Mr. Ragatz: I won't object to 35. I mean, I am going to argue its relevance and want to cross-examine.

But as to 34 and particularly Example 2 on 34, unless the Department is willing to provide us with information on companies where their result of weighting in effect reduces the taxable income, I don't think that there is any foundation for Example 2. And I am going to object to its admission into evidence as purely hypothetical unless there is some factual foundation. And the Department has categorically refused to give us that kind of facts so that we can make an examination for ourselves and draw our own conclusions.

Mr. Timken: Mr. Shapiro?

Mr. Shapiro: This is an example merely showing the arithmetical results. It is not contended to illustrate specific factual cases.

Mr. Timken: It's a hypothetical?

Mr. Shapiro: It's a hypothetical example for illustration purposes only.

Mr. Timken: Well, we will receive Exhibit 35 and we will also receive Exhibit 34 assigning probative value to it when we review the record; and we will note your objection, Mr. Ragatz.

Mr. Shapiro, you may proceed.

Mr. Shapiro: I have no further questions at this point.

Mr. Timken: You may cross-examine.

Mr. Ragatz: Can I have a couple of minutes?

Mr. Timken: You surely may.

Mr. Timken: You may proceed.

Cross-Examination

By Mr. Ragatz:

Q. Mr. Hoel, you testified as to the practice of weighting the cost of manufacturing factor. Are there any rules or regulations that have been published and prescribed, prescribing this procedure?

A. They were included in the 1932 regulations of the Department, but I believe in 1940, I think that was the year that the Redbook Rules were published. The rules were condensed considerably and that particular portion was left out of the new rules.

Q. Since 1940 there has not been published rules or regulations describing this procedure, has there?

A. Not to my knowledge.

Q. And only when we were granted the rights of discovery did we get any insight through your documents as to this procedure, isn't that correct?

A. As far as I know.

Q. And no other taxpayer besides our client has been given similar exposure to these rules, have they?

A. No.

Q. Now, you indicated that you rely on Section 71.07, subsection 3 as authority for the weighting?

A. Yes.

Q. Now I wonder if you could point out to me what language in that subsection you feel provides that authority?

A. The section provides that, "It shall be shown to the satisfaction of the department of revenue, that the use of any one of the 3 ratios above provided for gives an unreasonable or inequitable final average ratio because of the fact that such person does not employ, to any appreciable extent in his trade or business in producing the income taxed, the factors made use of in obtaining such ratio, this ratio may, with the approval of the department of revenue, be omitted in obtaining the final average ratio which is to be applied."

I think the rationale—

Q. I didn't ask you for the rationale. I asked you what statutory language says that you can omit part of a ratio?

A. Well, I believe it is implied if you can omit a ratio in total, you should be able to omit a part of a ratio.

Q. It doesn't say that in the statute, does it?

A. Not specifically.

Q. Now I refer you to your Exhibit 34 and would you agree with me that the impact on your Example 1 of weighting for a company that doesn't have any manufacturing in Wisconsin is to increaase its taxable income?

A. That's correct. If—well, presumably they would have some sort of a factor in the other factor, so if the manufacturing was zero in all ways and you weighted it, it would produce more income in Wisconsin.

Q. And then comparing that to your second example where there is manufacturing in Wisconsin, you are saying, as I understand your example, that if that manufacturing percentage exceeds the percentage of property in sales, that the impact would be to reduce the taxable income?

A. That's correct.

Q. Now most large manufacturers that operate in the country to which you might apply this formula probably don't have manufacturing activities in the State of Wisconsin, do they?

A. Well, there are a good number of them that don't.

Q. Isn't it a fact that the application of this formula as illustrated by your exhibit results in a discrimination against corporations that have no manufacturing activities in the State of Wisconsin?

Mr. Shapiro: The witness shouldn't be asked to answer that question.

Mr. Ragatz: If he is going to submit a hypothetical example and explain what the ramifications are, then he should be required to answer such a question based upon that hypothetical example.

Mr. Timken: The witness may answer.

A. I don't think weighting the factor discriminates against anyone, if we apply it uniformly.

Q. But you agree that for the company that has no manufacturing in the State of Wisconsin, the application of the weighting is likely to increase its taxable income?

A. I think obviously it would.

Q. And for the company that has manufacturing in Wisconsin, the impact of the formula, at least as you have illustrated it, reduces its taxable income?

A. Only if the manufacturing factor exceeded the average of the other two factors, and that is not always so.

Q. But now you are dealing with a hypothetical, so let's—let's take Example 1 as being the out-of-state manufacturer with no manufacturing activities in Wisconsin, and let's take the Example 2 as being the identical company except that this plant, instead of being located in Illinois, is located in Wisconsin. Now the company under Example 1 is going to pay more Wisconsin tax than the company located under Example 2?

A. That's correct.

Q. Despite the fact that in Example 2 the plant is in Wisconsin, there is more physical contact with Wisconsin, correct?

A. I don't think that is really the—really what we are trying to get at in weighting the cost of manufacturing factor. This may be the result.

Q. You are trying to get at producing more revenue for non-Wisconsin manufacturing companies?

A. No, I don't agree with that.

Q. Now the purpose of the Legislature in providing a three-factor formula was an attempt to give some balance and consideration to the various activities that the Legislature deemed contributed to taxable income within and without the State, correct?

A. I would say that is a reasonable conclusion.

Q. So when the Department unilaterally changes one of the factors, it really changes the impact that the Legislature's statutory formula would otherwise have, wouldn't it?

A. I think they give us the prerogative under 71.07 (3) to eliminate a factor. They also give us the prerogative under (5), I believe, to devise a different formula.

Q. But that you haven't done, at least in terms of prescribed rules and regulations, have you?

A. No.

Q. Let's look at sub. 5.

A. Excuse me, we do have special rules for apportioning income.

Q. But you don't have any that apply to the oil and gas industry?

A. No.

Q. I would like to read for the record subsection (5) of 71.07, "If the income of any such person properly assignable to the state of Wisconsin cannot be ascertained with reasonable certainty by either of the foregoing methods, then the same shall be apportioned and allocated under such rules and regulations as the department of revenue may prescribe."

A. Yes.

Q. As to the oil and gas industry, there are no such rules and regulations published and prescribed, are there?

A. We have one catch-all rule that practically duplicates the section you are referring to where we don't have a special rule, and then under this rule we can apportion under some other formula.

Q. So you are usurping the Legislative authority to decide that you can have secret provisions without publishing, is that what you are saying?

A. I think that rule is published.

Q. That rule is published, but the rules as applied to the oil and gas industry are not published, are they?

A. No, we don't have a special rule for them.

Q. And the barrel formula and your weighting of cost of manufacturing and all of the mechanical steps that have been discussed in evidence all day today appear nowhere in prescribed rules or regulations, do they?

A. No.

Q. Now you testified that the weighting process had been carried on by the Department since 1932, but we still today have no way of telling who benefited and who paid more tax because of the application of that factor, do we?

A. No.

Q. Our client has no way of determining whether it is getting fair and equal treatment under your application of that rule?

A. I don't know how the taxpayer would be aware of that, no.

Mr. Ragatz: I would like to ask a question under peculiar circumstances. I don't agree to this subject being inquired into by counsel for respondent, but because the question was permitted I would like to ask a question without being deemed to have waived my objection to it for purposes of the record. So, I have said that for the record.

Mr. Timken: Go ahead.

By Mr. Ragatz:

Q. Mr. Hoel, in your long experience with the Department of Revenue, can you tell me in how many instances the use of the weighting factor has produced less taxable income to any specific taxpayer? I am not asking you to name them right now. I am just saying, how many specific instances has this occurred?

A. Well, I can think of sitting in on at least a couple of staff conferences with our field auditors where this question came up and it was directed to weight, the cost of manufacturing factor, and we have the Cooper, Inc. case that we have a decision on before the Board, where weighting of the cost of manufacturing actually reduced the income of the corporation, although because of other issues involved there was additional tax.

Q. You can think of two situations; is that it?

A. Where it benefited the taxpayer? I say I can think of at least two, but—

Q. Since 1949 when you have been in the Department?

A. Well, when I was a field auditor I didn't have occasion to have an overall review of mostly audits that I now do have.

Q. I would like to now refer to Exhibit 35. I take it that your Exhibit 35 is really a rerun of petitioner's Exhibit 29 substituting—

Mr. Shapiro: I object to that.

Mr. Timken: On what grounds?

Mr. Shapiro: The tone of the question implies that we are copying something from the petitioner, and it is entirely uncalled for.

Mr. Timken: Mr. Hoel can respond to the question.

Mr. Ragatz: Before you rule on that, let me read the title of our exhibit and their exhibit. Our title reads, "Humble Oil and Refining Company, 1965-1968 Wisconsin Corporation Franchise Tax Audit Comparison of Net Income from Marketing Department with Assessed Income from Wisconsin Marketing Operations."

Now, on Exhibit 35, "Humble Oil and Refining Company, 1965-1968 Wisconsin Corporation Franchise Tax Audit, Comparison of Net Income of Total Company with Assessed Income from Wisconsin Operations."

There are about two words changed in the title. I can go on and do the same thing with the title. I am not trying to be derogatory. I am saying that as a matter of statement. We didn't copyright our exhibit. It's all right if he uses it.

Mr. Shapiro: The tone is derogatory.

Mr. Timken: Whether the tone is derogatory or not, we will allow the witness to answer, and if he wants to deny, he may deny if that's the fact, so I will overrule the objection and let the witness answer.

Is it a rerun?

The Witness: Well, frankly, it certainly is patterned after that exhibit, and I think you will find the first three columns are the same as what you have in your exhibit, but the last three columns show total company figures.

By Mr. Ragatz:

Q. And these total company figures include all functions including the E and P functions and refining function, and the marketing function as well?

A. Yes, the total sales to the net income comes off the audit report, I believe. I don't know if it is the apportionable income or the total company figure; that could be checked.

Q. Well, are the sales the total sales or the apportionable sales?

A. The sales are as computed on the lower part of the exhibit. They are total company sales. I believe we will agree with the total company sales as shown on your exhibit after elimination of inner-department transfers.

Q. So they are total sales, not just apportionable sales?

A. These are total company sales with the adjustments as shown on the exhibit.

Q. So you are comparing total company sales of allocable and apportionable income with your Wisconsin sales?

A. You mean we are comparing these total figures with Wisconsin?

Q. But you are comparing Wisconsin marketing sales with total company sales which include both allocable and apportionable sales?

A. Yes.

Q. And the sales, total sales, do include E and P and Refining and the minor functions and Marketing in total sales?

A. Yes.

Q. And Wisconsin sales are only marketing?

A. I believe so. These are the Wisconsin sales, but I believe they are shown on the sales factor, apportionable factor.

Q. I take it that because you prepared this you don't think you are comparing apples and oranges?

A. No, I don't think so.

Mr. Ragatz: No further questions.

Mr. Timken: Any redirect?

Mr. Shapiro: Yes, briefly.

Redirect Examination

By Mr. Shapiro:

Q. In both instances, in Columns 1 and 3 these figures represent gross sales, do they not?

Mr. Timken: You are referring to Exhibit 35?

Mr. Shapiro: 35, yes.

The Witness: They are gross sales after eliminating the taxes on the products sold and the cash discounts, and I believe the Wisconsin sales also had these figures eliminated. Now, I believe that is correct.

Q. In both instances the figures are gross sales?

A. Yes, on comparable basis.

Mr. Shapiro: I have nothing further.

Mr. Timken: Any further questions, Mr. Ragatz?

Recross-Examination

By Mr. Ragatz:

Q. But Wisconsin sales would include allocable and apportionable income, if you could compare, and then they would all be the same because whether it is allocable or apportionable in Wisconsin it is still Wisconsin income; it is still a Wisconsin sale so you are comparing that number with the total company number that includes both allocable and apportionable, correct?

A. Yes.

Mr. Ragatz: No further questions.

Mr. Timken: Thank you, Mr. Hoel. You may step down and we will adjourn until 9:30 tomorrow morning.

(Witness excused)

Mr. Timken: Mr. Ragatz, you will then put on your last witness tomorrow?

Mr. Shapiro: I have one comment for the record. I would like to state that one of our respondent's expert witnesses is not available until Thursday. I don't want that to cause you inconvenience, but for the Commission—

Mr. Timken: I don't think that it will. We will work around it.

(Proceedings adjourned, 4:37 p.m.)

WISCONSIN TAX

STATE OF WISCONSIN APPEALS COMMISSION

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),

Petitioner,

Docket No. I-3806

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

CERTIFICATION

KAREN A. CHERRY
MINDLA COMINS
LORETTA PETERS,

hereby certify that as the duly appointed reporters, we took in shorthand the testimony and proceedings had in the foregoing matter on the 8th day of October, 1974, and that the attached is a true and correct transcription of said shorthand notes and of the whole thereof.

Dated this 8th day of October, 1974.

/s/ Karen A. Cherry
Karen A. Cherry

/s/ Mindla Comins
Mindla Comins

/s/ Loretta Peters
Loretta Peters

TRANSCRIPT OF PROCEEDINGS in the above-entitled matter held before the Wisconsin Tax Appeals Commission, in Room 229, City-County Building, Madison, Wisconsin, on the 9th day of October, 1974, commencing at 9:30 in the forenoon.

Mr. Timken: Back on the record.

Mr. Ragatz: The petitioner calls Professor Ezra Solomon.

PROFESSOR EZRA SOLOMON, called as a witness, having been duly sworn under oath, testified as follows:

Direct Examination

By Mr. Ragatz:

Q. State your name for the record, please.

A. Ezra Solomon.

Q. Where do you live?

A. Stanford, California.

Q. How old are you?

A. Fifty-four.

Q. Would you review your academic training for us, please?

A. I graduated with a Bachelors Degree of Economics at the University of Rangoon, Burma, and then I came to this country after World War II to do graduate study and completed my Ph. D. at the University of Chicago in 1950.

Q. Would you review the academic positions that you held for us, please?

A. Outside of some small amount of teaching in Burma before World War II, it has been mainly at the University of Chicago where I served on the Faculty from 1948 to 1960, and since 1961 I have been Professor of Finance at the Stanford University, California, and since 1965 I have held the Dean Witter Professor of Finance, Stanford University.

Q. What was the major subject of your Ph. D.?

A. Economics and finance.

Q. Is that your major interest at this time?

A. It still is my major interest.

A. And in your present position are you teaching at the graduate level or undergraduate level?

A. Entirely at the graduate level at the time.

Q. Would you describe your professional activities and publications?

A. I served as editor of the *Journal of Business* from 1953 to '57. I have served on the Editorial Board of the *Journal of Finance.* I have been a Consulting Editor in Finance, Prentice-Hall, and served as the General Editor in a series called *Foundation of Finance Theories.*

I have served on the Editorial Board of the *Journal Quantitatve and Financial Anaylsis,* and on the Board of a British Journal called the *Journal of Business Finance.* I have published articles and books in the field. The major books are *The Theory of Financial Management* in 1963 into seven foreign languages, *That Management of Corporate Capital* published in 1960; a book on *Money and Banking,* which has gone into five editions, a parallel book called *Money and Banking in Canada,* a book on *Metropolitan Chicago.*

Q. Have you also published articles in professional journals?

A. Yes, I have.

Q. Would you review your government service experience?

A. My major full-time service with the government was that I was a member of the President's Council of Economic Advisors from 1971 to 1973, but I have also served on other activities.

Prior to going to the Council I was a member of the Presidential Commission on Financial Structure and Regulation. I have served as Consultant and am still serving

as Consultant to the Council of Economic Advisors; as a Consultant to the Secretary of Treasury, and the Board of Governors of the Federal Reserve Systems.

Q. Now, in addition to these activities, have you been active in governmental energy activities?

A. Yes, I participated in a large number of the Federal Power Commission Area Rate proceedings on the price of natural gas.

Q. Would you review your business experience for us, particularly as it applies to the oil and gas industry?

A. Well, in addition to serving as a Consultant to a number of companies on the area rate cases, during my stay on the Council itself, I was a member in charge of energy matters and that is the limit of my direct experience with the companies.

Q. Would you mention a few of your other consulting positions?

A. I am now serving as a consulting economist with Heiden, Shearson and Hammill. I'm sorry, it is Shearson, Heiden and Stone, a large Wall Street brokerage company. I serve as a consulting economist to the Wells Fargo Bank, to the Castle and Cooke, Incorporated, to a group of economic consultants called Management Analysis Center. I have served as a consultant to the American Institute of Certified Public Accountants, and on occasion to the Financial Accounting Standards Board.

Q. Have you served at any time as a consultant to any committees of Congress?

A. Yes, I have served as a consultant to the United States Senate Committee on Banking and Currency.

Q. How about any foreign governments?

A. I have served as a Consultant to the Government of Manitoba. I should mention that I did work for the Department of Energy for our own government here at one time, and I was a member of the Commission on Higher Education for Australia.

Q. In addition to your academic activities in this country, have you lectured elsewhere in the world?

A. Yes, I have. I have visiting professorships in this country as well as abroad, in 18 or 20 countries.

Q. In connection with your business experience in the oil and gas industry, would you describe the types of companies that you have had experience with?

A. Well, they were all of the companies who were technically respondents in the area rate proceedings. The cases were tried collectively for all of them and most of the major companies that were involved produced gas.

Q. I assume this is a matter of public record so there will be no confidentiality problem. Could you mention the names of some of these companies?

A. Yes, Phillips was certainly one; Exxon was, and prior to that Humble.

Shell was involved, Standard of Indiana, and Standard of California.

Q. I presume these are all multi-functional multi-state corporations in the industry?

A. Yes, although the so-called producers group technically represented all producers in the area that was being covered.

Q. What background have you had with the Exxon Company U.S.A., and its predecessor, the Humble Oil and Refining Company prior to this case?

A. Only my experience in connection with the natural gas cases.

Q. Would you describe that in a little more detail?

A. Well, these cases presumably were attempts to derive a fair price for natural gas at the well head, and it involved the whole issue of an appropriate rate of returns and an appropriate basis to be used and the efficiency of production of gas.

Q. How long did this continue?

A. Well, the first one began in 1961 and went on almost continuously and still are going on.

Q. How long have you been following the activities in the oil and gas industry?

A. Since 1961.

Q. Now I would first like you to talk about three terms: unitary, integrated and integral parts; and perhaps, first, you could explain these terms in the common layman's sense in which they were sometimes used and then explain them as an expert economist, if you would.

A. Well, like so many terms in the applied social sciences, these three terms that you name don't have an objective, unambiguous meaning. They have to have a meaning within a context in which they are used.

For example, in the purely layman or literal sense of the word, unitary applies to anything from the atom to the whole universe in fact. The universe has the word "uni" in it, too. In other words, it is thoroughly meaningless because it could apply to anything.

And the same thing could be true of the word integrated which means to bring together. Used in a business context, all businesses, small and large, from the family restaurant onward integrate or bring together several different processes or operations. So there, too, it has no particular meaning. Everything is integrated; everything is unitary.

One has to move from that kind of literal dictionary meaning to a more functional economic meaning. And there I think the essence of a unitary operation refers to that collection of activities which can feasibly be conducted as an economic unit in the marketplace. It may itself consist of many little steps, but they have to be performed collectively to provide economic viability. Such a company would be a unitary company, meaning each operation is essential to its viability in making a profit at all and you cannot do without any of them.

Q. Well, now, are the terms integrated and unitary synonymons?

A. No, not in an economic sense. If you use the word unitary in the sense that I have just described it for economic purposes as that minimum unit which provides economic viability, then integrated has in effect the opposite sense of unitary. We refer to an integrated company such as Exxon as being a company which brings together unitary groups that could survive independently but are brought together for purposes of providing greater economics of scale of one kind or the other.

Now the act of integrating in an economic sense is not to be confused with the purely technical sense of bringing together. In an economic sense you bring together unitary businesses and you call that an integrated company.

Q. Now would you explain the difference between the use of the term vertical integration and the use of the term horizontal integration and relate that to this discussion?

A. Well, when you bring together several stages or unitary businesses which perform services at several stages in an industry, you call that a vertically integrated firm. For example, if you had a cattle-feeding operation and then you decided to go into a meat-packing operation, which is a further stage of production, or even further into producing specialized meat products like Oscar Mayer, then you would have a vertically integrated firm in the meat industry.

Likewise, in the steel industry you could refer to vertical integration either forwards or backwards. You integrate backwards if you are a steel company by acquiring sources of iron ore or the transportation to bring the iron ore to your steel mills; or you can integrate forward into converting your steel into fabricated products.

Horizontal integration refers to the combining of unitary businesses that produce similar products, not prod-

ucts at a different stage; and a typical horizontally combined business might be a chain of department stores all of which sell roughly the same product and you combine them all under one corporate shell.

Q. Going back to the word unitary for a minute, what would you say is the essential ingredient for an economic unit to be considered unitary?

A. I would say there are several criteria you could use, but one of them would be the essentiality of each component part of that unit to the viability of the unit. This would be one test of the fact that it was a unitary corporation.

Other tests could exist. One, for example, would have to do with the availability of the perimeter of this unit we are talking about of a price for the output of the unit. There has to be a well-established price for whatever product that unit produces. This would give us the perimeter that bounds a unit.

A third approach would be that if the substantial part of cost of producing that product which has a price are easy to identify in terms of that unit's activities, that would create a unit in my opinion.

So there are three things, the essentiality of each component part one to the other, the presence of a firm and clean price for a product at that stage and the presence of identifiable costs for those operations.

Q. Now does the element of essentiality include the idea that it cannot be feasibly severed in an economic sense?

A. Yes.

Q. Now is the concept severable or severed, does it have to severed in order to be unitary or if it is severable, is that sufficient?

A. No. I am not quite sure whether you are talking about the component part of the unit itself. A unitary

business has many component steps. If those steps have to be performed in combination, that group of steps is the unitary business.

Q. If you could segregate out one step and perhaps substitute that by purchase from the outside or sale to the outside, would that step be considered part of the unitary business?

A. It would vary from one business to another. I say the definition cannot be precise here. Generally a unitary business is one that performs all of the essential steps required to keep it viable and it doesn't perform anything else that is not essentially required for the production of that product or that commodity.

Q. Now would you relate that definition now to your definition of integrate?

A. Well, by integrated I mean a combination under one corporate management of many unitary businesses. If the unitary businesses are all in the same line of activity, we call it a horizontal integrated firm. If they are at successive stages in the business, we call it a vertically integrated firm.

In other words, an integrated firm consists of several unitary businesses.

Q. Which are not necessarily unitary as to each other, just unitary as to themselves?

A. The whole thing in not unitary, no. The units are these parts that are combined in forming a corporation.

Q. Now would you distinguish between the term integrated and the term integral?

A. This again, while it is almost precisely the same word, the meanings are almost exactly the opposite of each other.

When you referring to something being an integral part of something in an economic sense you mean it is an operation or a process which cannot be done without for that unit to function. And indeed the very nature of an

integrated firm, as we use it in economics, is that you bring together units that need not belong together, that can very well exist not in combination with each other.

It's entirely possible to have a livestock feeding operation without having a packing house. It's entirely possible to have a packing house without having a livestock feeding operation. And it's possible to be a sausage manufacturer without having either of those two things. If you do have such a vertically integrated firm, you are bringing together—not forcibly, but a man is bringing together things which naturally don't have to be together.

Q. Can there be an integral part without there first being a finding of unitary?

A. Not in my opinion. You have got to find that something is unitary in order to identify that which is an integral part of that unitary business.

Q. I would like to give you a couple of hypothetical examples so that you can illustrate the definitions we have just talked about.

My hypothetical involves a large corporation having its headquarters in Chicago. This corporation has two divisions, each of which constitute a separate business. The Chicago Division operates a plant which makes and sells garbage trucks. The Madison, Wisconsin Division operates a retail store selling women's fashions.

Now this corporation operates in one corporate entity and it operates both divisions under a common name. Let's call it Solomon's, has one Board of Directors, has one Chairman of that Board, it has one president, it has common officers except that two of the vice-presidents have specific assignments, one to each division, both of these vice-presidents being members of the Board of Directors.

Now based upon those facts, do you have an opinion as to whether that hypothetical corporation would come within your definition of unitary?

A. No, it would not. Each of the divisions would be a unitary business and the corporation would be a conglomerate, I imagine, which combines these two. By very definition a corporation or a firm has single management or single name, but this doesn't make the corporation unitary in the economic sense we are using.

Q. Now would it change your conclusion if this corporation had a common Planning Department?

A. No, I imagine a Planning Department is a necessary adjunct of a Board of Directors. If it has one Board of Directors it ought to have a Planning Department.

Q. Would it change your conclusion if this corporation also had a common Secretary's Department?

A. No.

Q. If it had a common Treasurer's Department?

A. No.

Q. If it had one controller?

A. No.

Q. If it had one Tax Department?

A. No.

Q. If it had one Law Department or House Counsel?

A. No.

Q. If it hade one Public Relations Department?

A. Again, no.

Q. And if it had one Employee Relations Department?

A. No.

Q. If it had combined miscellaneous staff services at the corporate level?

A. If there were staff services, no, it wouldn't change my mind that these were two separable unitary businesses under one corporate shell.

Q. Now do any of these criteria I have just discussed in themselves indicate that that corporation would be classified as unitary?

A. No.

Q. Now do all of the criteria combined change that conclusion?

A. No.

Q. And I guess you have already said whether any of these facts make the total corporation business unitary?

A. They do not in my opinion.

Q. Now let's take another example of a vertically-integrated corporation composed of separate unitary businesses. Perhaps your example in the raising and feeding of livestock, the packaging house and so on, if that kind of a business had a common name, common board of directors, common chairman and president and officers, does that make that total corporation business unitary?

A. No.

Q. And if that vertically-integrated business had the other criteria that I have just gone over with you, common Planning Department, corporate Secretary's Department, Treasurer's Department, controller, Tax Department, Law Department, Public Relations Department, Government Relations Department, Employee Relations Department or other business staff services, would that make the vertically-integrated corporation one unitary business?

A. No.

Q. Now, if you added to that the fact that there was brand identity as to that vertically-integrated business, would that change your conclusion?

A. No.

Q. And would brand protection make any difference?

A. No.

Q. Or quality control as to product?

A. No.

Q. Now what if that vertically-integrated business had common capital budgeting at the corporate level? Would that make any difference?

A. Again, no, that is why you have a corporation.

Q. What if this vertically-integrated business operated across state lines? Would that make any difference?

A. No.

Q. I would like to, in order to put this matter now into context, read to you briefly from the Statute involved in this case which is Section 71.07(2): "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and properly located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof when the business of such person is not an integral part of a unitary business," and then the statute goes on. As I read this statute it requires a factual determination as to the terms "unitary" and to the term "integral part." Now as an economist, at my request have you studied the use of these terms and the statutory context?

A. Yes, I have.

Q. Can you please explain the factual considerations involved in making the determinations required by the statute?

A. Well, these are, as I have explained, dormant terms that have both literal connotations and dictionary connotations as well as what I regard as meaningful, functional economic connotations, and from the point of view of the latter basis, the economic connotations, I would say those three criteria I mentioned earlier would be the useful ways of limiting what is a unitary business and what is not, and these were the criteria that—if there is a clear price available for the product of this unitary business, then everything inside that price is a unitary business. However, if the company we are talking about is an integrated company, either a horizontally-integrated company or a vertically-integrated company or a conglomerate con-

sisting of many unitary businesses, I think one could draw the line between the total corporation and the component unitary businesses within it in terms of—this is what I call "price factor."

If the individual component units are producing a product that has a well known price available daily or hourly or what have you, then that component is unitary, but the whole thing is not.

Q. Now do these factual considerations involve your definitions of the word "integrated" or "integration"?

A. Yes, I would use the word "integrated company" in the sense I have been using it, a combination of unitary businesses that doesn't have to be that way. The unitary businesses could exist on their own or they could exist in some different combination than the combination encompassed by the company involved. It is not essential that the corporation as a whole have all the unitary businesses it does have. It could get along fine with fewer or more.

Q. On that subject would you comment on the composition of the oil and gas industry as to the types of companies and the functions that they have that make up the industry and relate that to your definition?

A. Well, the oil and gas industry has a large number of companies ranging all the way from what I call unitary businesses that are performing essentially at one stage of the total industry's operations, all the way up to highly vertically, horizontally, internationally integrated corporations, and you can think of many examples from each of these fields. They are more or less the pure producing companies whose product is crude oil and sometimes natural gas. These are unitary companies essentially. They may well be horizontally integrated, as well.

You may have companies which are essentially only refineries. They purchase their crude oil and they sell their products to some other marketing groups.

There are some which are only marketers—only marketing companies. There are some which combine marketing and refining, some which combine all three stages, production, refining and marketing, and the latter group all called the fully-integrated companies. Most of the large ones are fully integrated companies.

Q. Now again, just to be sure I am clear on this, the use of the term "fully integrated" is not the same as saying that the difference is unitary.

A. No, precisely the opposite.

Q. I would like to read you next from the Department of Revenue's Corporation Section Training Manual, and these chapters have been admitted into evidence in this proceeding as Exhibit 10a, and I am referring specifically to Page 323 of that manual, and I believe it is in front of you, and in the middle paragraph is a statement on "unitary" that I would like to read to you: "A unitary business is one which operates as a unit. Its business cannot be segregated into independently operating branches. Its operations are integrated and each branch is dependent upon and contributory to the operation of the business as a whole."

Would you comment on that definition in light of your testimony?

A. Yes. It fits what I am talking about in the way of a unitary business. The unitary business, as I pointed out, is one where the component part of that business cannot be separated into viable independent activities, which means that each component activity is dependent upon some other component activity, contribution runs both ways. This is the minimum level at which you can operate that and stay in business, given the economic condition that we have. I would agree to the statement.

Q. Would you comment on the use of the word "integrated" in that definition?

A. Yes. The word "integrated" in this definition is being used in what I call the laymen's sense of the word that it is bringing together the essential components required to comprise a viable entity. It is not being used, I think, in the sense that I have been using it in connection with vertical integration, horizontal integration or conglomerate integration.

A. (Continuing) I might add that I would agree with statement including the use of the word "integrate" if you would say its operations are naturally and/or inevitably integrated rather than integrated by the act of man for other reasons.

Q. The definition says that each branch is dependent upon and contributory to the operations of a business as a whole. That would appear to be two requirements.

Would you comment upon these requirements?

A. There is reciprocal dependence of each component process on other components processes. You can't have one without the other in the same sense that there is no point on making just left shoes without making right shoes. The saleability of them for the most part depends on making both.

Q. Would that term be synonymous with your previously-used term of "essentiality"?

A. Yes.

Q. And a vital part of the whole?

A. Correct, vital, necessary; that if you removed part of a process from within what I called a unitary business, it is likely to operate at a loss or not have a market for its products.

Q. Would you comment upon the contributory requirement?

A. Well, it is the other phase of the dependent one, part of it. One branch is called one process, one operation.

One depends on the other and the other one depends on the other one, and each mutually contribute to the other and depend on the other.

Q. Do you view these as two requirements?

A. Yes, I think it is a useful test to look mutually between processes within what I call a unitary business.

Q. In applying that kind of definition would you comment upon what impact the operation of a business across state lines would have?

A. It would have no differences as far as the economic definitions are concerned.

Q. The fact that the business is multi-state, does that make it unitary?

A. That does not make it unitary at all.

Q. In preparation for your appearance here today I would like you to describe the background which you obtained in the matter at issue here; first perhaps telling us how long ago you were engaged?

A. Well, I was engaged about a year ago, if I remember right. Mr. McBride came to see me at Stanford and we talked about the case, and I agreed to participate and have since been following the development of the case. I have reviewed, for example, the transcripts up to yesterday.

Q. Up through yesterday?

A. Yes.

Q. What other background have you obtained in the case?

A. Well, we had several meetings of the people who were going to serve as witnesses in the case and discussed the issue of semantics involved in the case and the economic concepts.

Q. How many conferences did you attend, do you recall?

A. I think I have had three conferences in all.

Q. And have you been provided with documents related to the case?

A. Yes, I have.

Q. Have you examined the documents?

A. Yes.

Q. Have there been any other background materials that you have examined?

A. Well, I read, in addition to the documents that you sent me, whatever books I felt might be relevant to the oil and gas industry; at least I might say I reread them.

Q. Are you familiar with any previous court decisions in the area?

A. Yes, I read one document which provided a run-down on the previous court decisions.

Q. And did that include the Minnesota Skelly case, do you recall?

A. It did.

Q. Have you reviewed the functional organization of Humble?

A. Yes, I have. One of the documents I was provided with contained details on the functional organization of Humble, and then there was Mr. Luper's testimony a few days ago.

Q. Have you also participated in conferences where that organizational structure was discussed?

A. Yes. One of the meetings we had Mr. Luper was present, and we were talking about his testimony.

Q. Are you familiar with the functional organization of other members in the industry?

A. Yes.

Q. I believe you indicated that you have reviewed all the testimony to date in this hearing?

A. Yes.

Q. Now, based upon your extensive background as an economist, your experience in the oil and gas industry, and your reliance upon the record in this case to date, do you have an opinion on whether during the years 1965-'68 Humble was an integrated company?

A. Yes, it was an integrated company.

Q. Do you have an opinion on the same basis as to whether Humble was a unitary company?

A. No, by my definition. If it is integrated, it is by definition not unitary.

Q. And on the same basis do you have an opinion as to whether the functional operations of the Humble Exploration and Production Department, the Refining Department and the Marketing Department were carried on as separate businesses?

A. Yes, these are three separate unitary businesses, and if I remember right, there were even more, but these are the three major important stages that a vertically integrated company combines.

Q. Each stage, E and P, Refining and Marketing, you would say were separate businesses?

A. Yes.

Q. On the same basis do you have an opinion as to whether or not the Wisconsin Marketing operations were an integral part of the Humble E and P function?

A. No, they are not.

Q. Did you find any economic dependence between the Wisconsin operation and the E and P Department?

A. No, none whatever. It appears that Humble's E and P Department was a functioning unit even before there were any Wisconsin operations.

Q. Could it have been feasibly economically severed from the company without damaging the Wisconsin operations?

A. I missed the question.

(Question read)

A. What is the "it" in the question?

Q. The E and P Department.

A. Could Humble's E and P Department sever its relationship with the Wisconsin operation without affecting the Wisconsin operation?

Q. Right.

A. Yes, I imagine it could.

Q. And could the Wisconsin Marketing operations have been severed without damage to the E and P function?

A. Yes, the Wisconsin Marketing end of it didn't exist for a while, and after it existed, it could have been severed without affecting the E and P viability.

Q. Now, on the same basis as I previously asked, do you have an opinion as to whether the Wisconsin Marketing operations were during the years in issue an integral part of the Humble Refining Department?

A. They were not.

Q. Was there any economic dependence in that relationship?

A. Not that one could see from the record at all. The Refining Department was a unitary business that could have functioned with or without the Wisconsin Marketing.

Q. And so there was no—or the Department could have been feasibly economically severed without damaging the Wisconsin Marketing operations?

A. You could have a Wisconsin Marketing operation without having a Refining Department.

Q. Then in other words, there was an ample supply of products without obtaining them from Humble Marketing?

A. That's correct.

Q. Could the Wisconsin Marketing operations have been feasibly economically severed without damaging Humble's Refining Department operations?

A. Yes.

Q. So there was an ample demand for Humble's Refining products without the Wisconsin market?

A. Yes.

Q. And going back to the E and P Department for a minute, I take it that in the market there would be an ample demand for crude oil without the Humble Refining Department being in the picture so that Humble's E and P Department could have disposed of its crude oil produced?

A. Yes. Many companies exist as crude oil producers.

Q. And as to the Refining Department, there was an ample supply of crude oil in the market so that the Refining Department was not economically dependent upon Humble's E and P Department?

A. Not in the sense that I am using the word here.

Q. And the two departments could have been economically severed on a feasible basis?

A. The very fact that refineries exist as independent refineries and producers exist as independent producers and on a fairly large scale suggests that this can be done.

Q. On the same basis that I previously stated to you, do you have an opinion as to whether during the years in issue the Wisconsin Marketing operations were an integral part of Humble's Marketing Department?

A. This I find hard to say yes or no. We are not talking about very similar things, and there is no reason why they would not have been an integral part. It depends on the details involved. There is no reason why they could not have been really separate and not a part of the marketing operations.

Q. Would it have automatically followed that the Wisconsin operations would have been an integral part of the Marketing Department?

A. Not automatically, no. It would depend on the particular format used.

Q. If the Wisconsin Marketing operations could be separated on an economically feasible basis, could the Wisconsin operations be considered non-integral?

A. Yes, it could be that just the Wisconsin part of the Marketing function would be a separate business It can be so.

Q. So the test would be whether the Wisconsin Marketing operations could be feasibly economically severed?

A. Yes, that would be the test.

Q. And that would determine whether or not the Wisconsin Marketing operations was an integral part of the Marketing Department itself?

A. That's correct. It would depend on the circumstances.

Mr. Ragatz: No further questions.

Mr. Timken: We will take ten minutes.

(Recess)

Mr. Timken: Mr. Shapiro, you may cross-examine.

Mr. Shapiro: Thank you.

Cross-Examination

By Mr. Shapiro:

Q. Professor Solomon, a company that only operates refineries would have to depend upon its supply of crude oil from third parties and would have to depend on third parties also to provide a market for its refined products, is that not true?

A. Correct.

Q. On the other hand, an integrated oil company with its own resources of crude and its own marketing outlets would not have to depend upon third parties for raw products and markets for its products, is that not true?

A. It depends on its crude balance. Very few of them have exactly the same refining, marketing and production capacities.

Q. During a period of short supply of crude oil, is it true that the company which only refines crude oil might not be able to acquire its needs of crude oil to operate its refineries to the extent of demand for refined products whereas the company with its own crude oil supplies could operate its refineries to meet this demand if its crude oil sources were adequate, is that not true?

A. Yes, it would follow if its crude oil sources were adequate.

Q. Similarly, could the company with its Marketing Department have a more constant and assured market outlet for its refined products than the refinery company?

A. Well, that's the reason they do integrate vertically. They are under the impression that having their own brand-named outlets does give them that stability.

Q. Would this promote the more efficient operation of its refineries for planning its production?

A. Yes. Again, I think that is the main theory underlying vertical integration that it reduces the bumps and valleys that may occur because of excess demand for crude, excess demand for refined products or insufficient demand. In some cases the total risk of the integrated enterprises is lowered.

Q. Professor Solomon, you have studied the structure of the petroleum industry.

A. Yes.

Q. Have you published articles on the structure and economics of the petroleum industry?

A. I have not.

Q. Nor have you given any speeches on that subject?

A. No.

Q. Have you published books on the structure and economics of the petroleum industry?

A. Not books.

Q. Are you not testifying, Professor, on a theoretical, abstract basis about the petroleum industry?

A. Well, I am testifying about the petroleum industry and I am an economist and most economists are theoretical and abstract. But I am not unaware of what goes on in the industry.

Q. Are you aware of the variability of the return on investment for the exploration and production function, the refining function and the marketing function for the vertically integrated petroleum companies?

Mr. Ragatz: Objection. I am afraid we are getting into the anti-trust area and I don't see that this has any relevance to the case. I have stated my arguments previously; I won't burden the record with them. But I feel strongly that this line of inquiry should not be allowed.

Mr. Shapiro: We are discussing the three principal functions of the integrated oil company.

Mr. Timken: Would you read that question back again, please?

(Question read)

Mr. Timken: Objection sustained.

By Mr. Shapiro:

Q. Professor, does the accounting for profits for tax purposes and the accounting for profits for managerial and financial purposes necessarily lead to the same accounting result?

A. No.

Q. In fact, isn't it quite often true that tax accounting and financial accounting for profits can lead to quite different results for financial departments in an integrated operation?

A. Well, they can lead to different results for all kinds of companies, not just functional departments. Tax accounting is not the same as financial accounting and in the aggregate, the total figure reported by the IRS won't be the same figure if you add up all the company's books.

Q. If an integrated oil company with separate functional operations such as production, refining and marketing, has one function with favorable tax laws, wouldn't it be good business practice to divert as much of the company's overall profits into the low tax operations?

Mr. Ragatz: Objection. That hits anti-trust square in the face.

Mr. Timken: Sustained.

By Mr. Shapiro:

Q. Are you aware of the tax treatment of profits for the different functions of an integrated company?

A. You mean the various provisions for things like depletion?

Q. Yes, sir.

A. Yes, I am.

Q. Isn't it true that the tax laws favor the taking of profit of the vertically-integrated company in the E and P function?

Mr. Ragatz: Same objection.

Mr. Timken: Sustained.

By Mr. Shapiro:

Q. Under favorable tax treatment of oil, isn't it entirely possible that refining and marketing would report lower rates of return than production and might even lose money?

Mr. Ragatz: Same objection.

Mr. Timken: Same ruling.

Mr. Shapiro: I have no further questions.

Mr. Timken: Any redirect?

Mr. Ragatz: Give me a minute. I am ready.

Mr. Timken: You may continue.

Redirect Examination

By Mr. Ragatz:

Q. Professor Solomon, on cross-examination you were asked questions that seemed to be driving at a dependent relationship between separate functions of an integrated oil company. Would you comment on the concept of dependence in terms of demand and supply in the market itself as to whether or not everybody in business has some dependency on market conditions and distinguish that from an economic dependency in terms of the concept of unitary?

A. Well, in the case of a unitary business, the degree of dependence between the sub-components that comprise that unit are very strong. They are essential, they are necessary. You could not feasibly run it in today's economy, or whatever economy we are talking about, without all of those components.

In the case of a vertically-integrated company, the presence of business or unitary businesses within the vertical combination, the dependence is not as strong at all. It is quite a bit weaker. There is, obviously, some advantage for each unitary business belonging in a family of businesses. Size alone does provide some help. That degree of dependence is sort of trivial compared to the interdependence within each unit itself.

Q. In the market could you say that the dependence for a refinery would be that there be a supply of crude in the general market itself and that there not be a dependence between ownership of a producing function and a refining function?

A. Well, the common ownership of the two functions is not all that important in terms of the demand and supply of the flow of product, either crude or the products that come out of them. There is a well-established market for crude petroleum. It has a daily quotation. A refinery can

buy there, a crude producer can sell there. Likewise, at the refined end there is a clear cut market for petroleum products in which a lot of people engage and in which there are daily quotations so that the degree of dependence is not that great at all.

Q. In other words the refinery can get crude from market sources that have no ownership relationship to the refinery and, in turn, can sell its product to the market sources that have no ownership relationship to the refinery?

A. Quite. The total demand and supply for crude is balanced. It really doesn't matter where you get it. It's the same kind of thing and you get it at the same price anyway.

Q. Mr. Shapiro also asked you about financial accounting, tax accounting. In connection with the separate functions of a vertically-integrated company, is it possible to have separate financial accounting and tax accounting within each function?

A. I think it is. If I remember correctly, the way oil companies report for tax purposes, is not exactly the way they report for book purposes. This is true, of course, of a large number of other companies.

Q. No further questions.

Mr. Timken: Any further questions? Mr. Shapiro?

Mr. Shapiro: As a preliminary, Gentlemen, I wish to have the record made clear that respondent wishes to preserve its exception to the Commission's ruling that the questions just submitted to the witness should not be answered, and the sustaining of petitioner's objection.

Mr. Timken: Your objections are noted and preserved, Mr. Shapiro.

Anything further of this witness?

Mr. Shapiro: No, sir.

Mr. Timken: You are excused,
Professor, thank you.

(Witness excused)

Mr. Timken: Mr. Ragatz.

Mr. Ragatz: Petitioner rests.

Mr. Timken: Mr. Shapiro, you may call your next witness.

Mr. Shapiro: I would like to call Mr. Sheridan.

Mr. Timken: Mr. Sheridan, you have been previously sworn, so you may have your seat.

THOMAS SHERIDAN, recalled as a witness, having been previously sworn under oath, testified as follows:

Mr. Shapiro: Off the record.

(Discussion off the record)

Mr. Timken: Back on the record. Mr. Shapiro, you may proceed.

Direct Examination

By Mr. Shapiro:

Q. Mr. Sheridan, at the time you made your audit did you have available to you Mr. Kaspar's work papers of Humble?

A. Yes, sir.

Q And did you review them in connection with your audit?

A. Yes, I did.

Q. And what years did Mr. Kaspar's work papers relate to?

A. I believe it was 1960 to 1964.

Q. And what years does your audit relate to?

A. 1965 to 1968.

Q. In connection with your audit of Humble's books and records, did you rely on the information and findings in Mr. Kaspar's work papers, particularly with reference to whether Humble was a unitary business?

A. Yes, I did.

Mr. Ragatz: I might be hypocritical suggesting that that was a leading question, because I have quite a few myself, and I think with the technical nature of the subject that is kind of necessary, but with this particular witness I would appreciate it if he didn't lead. He should be able to testify.

Mr. Timken: Seeing that that wasn't in the form of an objection, I won't rule on it.

Mr. Ragatz: I will just comment, because this witness was the auditor on the audit, I think he should be able to phrase his own answers to the questions.

By Mr. Shapiro:

Q. I call your attention to Exhibit 11-6, and it is in the record, and to Page E4.1 therein, and I would ask you first to identify Exhibit 11-6.

A. This is part of my work papers in my audit.

Q. And the document to which I refer you on Page E4.1, would you identify that?

A. This is a schedule furnished to me from Humble showing therein crude oil barrelage data.

Q. And does that schedule conform to—well, strike that.

I show you also Exhibit 32, which is already in the record, and I ask you whether the schedule that you have before you from your work papers conforms to the example of the barrel formula set forth in Exhibit 32?

A. Yes, it does.

Q. I show you now what is marked as Exhibit 1 and I would ask you to identify that exhibit.

A. This is a copy of my audit report.

Q. Did you prepare the audit report?

A. The original—

Q. Did you prepare this report?

A. The original, yes. I think this is a typed copy. Mine is in handwriting.

Mr. Shapiro: The record should be made clear that the typed copy that we are referring to is an exact copy of the other—of the copy prepared by Mr. Sheridan. There is no problem with that, is that right?

Mr. Ragatz: No—

Mr. Timken: And it is stipulated in the record.

Mr. Shapiro: Yes.

By Mr. Shapiro:

Q. And who signed the covering letter or the letter of transmittal?

A. C. J. Hoel.

Q. And what was his position as related to yours?

A. He was chief of the Corporation Section.

Q. So that he was your superior?

A. Yes.

Q. Now I would like you to refer to Exhibit AB—Exhibit AB of your audit report, and state for the record what that shows.

A. Exhibit AB is a summary of the additional net income and the additional franchise tax due in connection with my audit.

Q. And now moving to Exhibit C, which is the next exhibit, is it not—

A. Yes.

Q. What does that exhibit show?

A. Exhibit C is a reconciliation from federal taxable income to adjusted net income. In 1965—we will take 1965 as a model year, we began with a federal taxable income before special deductions of $212,000,000. The principal adjustment is the reversal or removal of percentage depletion, since there is no statutory authority for this.

We then remove nonapportionable income in total.

Q. What is the amount?

A. $192,000,000. We then have—

Q. What is the income set forth just prior to that figure?

A. That would be $403,000,000.

Q. What is that figure?

A. That is an adjusted net income, total company-wide.

Q. All right. You may proceed.

A. From this adjusted net income of the total company, we remove that income which we consider nonapportionable, we then have a remainder—first of all, we remove the $192,000,000 and we have a remainder net income which we call apportionable income of $211,000,000. To this amount we assign the Wisconsin percentage, which is .4071, or a little less than one-half of 1 per cent.

We then have a Wisconsin net income of $859,000, to which we apply the nonapportionable income of Wisconsin, and in this case it happens to be a loss of $100,000, and the remainder then is the adjusted net income of $759,000; and this procedure follows all through the four years of the audit.

Q. Does the per cent to Wisconsin represent an average percentage?

A. Yes, it does.

Q. And is that figure used to determine——primarily to determine the amount of income that is attributed to Wisconsin?

A. Yes.

Q. Now would you please turn to the next Exhibit C-1, and describe for the Commission what that exhibit shows?

A. Exhibit C-1 is the information furnished by the company. It is a reconciliation of the surplus of Humble along with any adjustments it made to arrive at book income, and then adjustments made to arrive at federal taxable income.

In 1965 we have total surplus at the end of 1965 of roughly $2,700,000; we have a beginning retained earnings or surplus of $2,500,000, which gives us an increase in surplus in that year of $187,000,000.

Q. What is meant by book income?

A. Book income is income as reflected on Humble's books.

Q. And for 1965 what was that amount?

A. (Continuing) This book income of $462,000,000 is further adjusted for tax adjustments, and then we arrive at a federal taxable income, or rather the company arrives at a federal taxable income, and this is our starting point really for Exhibit C, and that is the purpose of showing Exhibit C-1.

Q. Turning to the next exhibit, is that Exhibit E?

A. Yes.

Q. Would you describe what this exhibit shows?

A. Exhibit E is a summary of the apportionment determined by the audit in 1965. This summary shows that the Wisconsin tangible property to total tangible property, or to apportionable tangible income is .6213, a little over one-half of 1 per cent.

The schedule also shows that the cost of manufacturing within Wisconsin is zero, and that the sales within Wisconsin are .4431 or a little less than one-half of 1 per cent.

These are summarized and then divided to arrive at an average percentage to Wisconsin of .4071, a little less than one-half of 1 per cent, and the same procedure is used in the other three years.

Q. And is the weighting of the cost of manufacturing similar to the procedure described by Mr. Hoel in his testimony?

A. Yes, it is.

Q. And then you arrive at the average per cent to Wisconsin which we saw previously?

A. Yes, we do.

Q. For each year?

A. Yes.

Q. Why are these three factors of tangible property, cost of manufacturing, and sales used?

A. These are the three factors expressed in the Wisconsin Statutes, Section 71.07.

Q. Why was the cost of manufacturing weighted?

A. Because the cost of manufacturing of Humble was less than the weight of one.

Q. What is the reason for the weighting of the cost of manufacturing?

A. The reason is because Humble's—there are many products which are not manufactured by Humble. They are in effect completed products purchased from other parties and just resold by Humble, and this part of the Statute is recognized in the manufacturing activity.

Q. Turning now to the next exhibit, is that your Exhibit E-1?

A. Yes, it is.

Q. Will you describe what that exhibit shows?

A. Exhibit E-1 is a summary of tangible property of Humble to arrive at the ratio of Wisconsin tangible property to total. Again in 1965 we started with total property on a book basis. We removed the property which is attributable to producing nonapportionable income.

Q. What is the book basis figure from which you computed this?

A. The book starting basis is $3,245,000,000. That would represent all property, plant equipment and inventory of Humble. We removed nonapportionable property of $594,000,000 to arrive at apportionable property, and then we averaged the beginning of the year and the end of the year to arrive at the total tangible property to determine

the Wisconsin per cent thereof. The same procedure is used in the other three years.

Q. Turning now to the next exhibit, is that Exhibit E-1.1?

A. Yes, it is.

Q. Will you describe that exhibit?

A. Exhibit E-1.1 and Exhibit E-1.2 are both supporting schedules to Exhibit E-1.

Exhibit E-1.1 is a computation of the nonapportionable tangible property or the property which produces nonapportionable income. In 1965 we begin with the total tangible property of the Exploration and Production Department of $1,700,000,000. We make a few adjustments to essentially arrive at that property of that department and then that gives us the figure of $891,000,000.

We then apply the nonapportionable percentage to that adjusted tangible property and that gives us the amount of property which is attributable to producing nonapportionable income which will be removed on Exhibit E-1.

In 1965 that figure is $594,000,000.

Q. So that you are not using in your three-factor formula the total amount of the company's property, is that right?

A. No, we are not. We are removing it.

Q. What is the reason for removing this portion?

A. We only use apportionable figures in determining the apportionable income. In other words, the other property which is associated to producing situs income is removed.

Q. Turning to the next exhibit, that is Exhibit E-1.2, is that correct?

A. Yes.

Q. What does that show?

A. Exhibit E-1.2 is a summary of determining the nonapportionable percentage of the Exploration and Production Department. In 1965 we determined the ratio of the net income from natural gas to the net income for the entire department. We have determined in 1965 that that is 21 per cent.

The reciprocal then thereof is crude oil; a part of which is apportionable and a part of which is nonapportionable. The nonapportionable percentage in this instance is 55.9186 per cent, and this figure was supplied by Humble.

We are saying that 55.9186 per cent of the remaining assets of the E and P Department are nonapportionable, and that is 43.9993 per cent so we have gas assets of 21.3155 and crude oil assets of 43 9993. We add the two together and that gives us the nonapportionable percentage for the E and P Department of 65.3148 per cent. This figure is carried over to the E-1.1 exhibit.

Q. Mr. Sheridan, you have heard the testimony presented in this case, have you not?

A. Yes, sir.

Q. And are you aware that the E and P Department is one of three major departments of the company?

A. Yes, sir.

Q. What is the reason for making this calculation to determine the parts of the E and P Department?

A. The reason is that we have all of these assets or these tangible assets in the Exploration and Production Department. We do not know specifically, nor can the company, or at least the company did not furnish information which can isolate specific assets earning specific income so we have attempted to isolate these assets which produced nonapportionable income in this method.

Q. What is the kind of nonapportionable income to which you refer?

A. We are talking about the sales of natural gas at the well, and we are talking about to third parties or to outsiders, and also the sale of crude oil at the well or down stream to third parties.

Q. Are you making a calculation here that the result in part of the net income of the E and P Department is not subject to tax because it is situs income so-called?

A. In this instance we are isolating taxable property but we will remove this situs income later on.

Q. So this calculation relates to separating tangible property into apportionable and nonapportionable property?

A. Yes, sir.

Q. Turning to the next exhibit is an exhibit E-2?

A. Yes, sir.

Q. And what does that exhibit show?

A. Exhibit E-2 shows the computation of the weighting of the cost of manufacturing factor.

Humble has stated and we accept the fact that Humble has no manufacturing activity within Wisconsin. We do know that Humble has the sales of many products which are manufactured by other vendors. Since our factor or the statutory factor is cost of manufacturing, we are attempting to only recognize cost of manufacturing and not purchasing. In this instance we have used a method which was set up in the prior audit of taking the ratio of apportionable sales, removing those products which were purchased from other vendors. Then we have to use figures in this. In 1965 we have Humble apportionable sales of $2,900,000,000. We remove refined products purchased from other manufactures. We remove automotive tires, batteries and accessories manufactured by other vendors; and we remove crude oil purchased from other vendors. We then have a net figure of $1,800,000,000 which represents the sales of Humble's manufactured products.

And we have taken the relationship between Humble's manufactured products to total manufactured products sold, both Humble's and other vendors, and this gives us in 1965 a weight of 61.4609.

Q. And that same procedure was followed in the other years?

A. Yes, it is.

Q. Is your next exhibit Exhibit E-3?

A. Yes.

Q. Please turn to that and state what that shows?

A. Exhibit E-3 is a computation of the Wisconsin sales to total apportionable sales as per the statutory formula. In 1965 we begin with total company sales. From these sales we remove those sales which produced nonapportionable income. In 1965, first of all, we have total sales of $4,000,000,000. We remove nonapportionable sales of crude oil of $326,000,000. We remove gas sales of I think it's $184,000,000. We remove Marine charter revenues of $6,000,000; and the remainder sales are what we call apportionable sales and we determine the Wisconsin percent thereof.

In 1965 we have apportionable sales of $12,980,000. And that gives the Wisconsin ratio .4431 percent or a little less than one-half of one percent of the total sales. And the same procedure is used in 1966, 1967 and 1968.

Q. Is the next exhibit Exhibit 3.1?

A. Yes, it is.

Q. Please turn to that and explain what that exhibit shows.

A. Exhibit E-3.1 is the computation of the crude oil produced and purchased. We know that Humble purchases vast quantities of crude oil. We begin with the crude oil and condensate sales of the E and P Department. We apply to that the nonapportionable percentage which we have previously computed to determine the amount

of those crude oil sales which produce nonapportionable income. And in 1965 out of total sales of this Department of $584,000,000, $326,000,000 are considered as sales generating nonapportionable income. That's entitled, I think, No. A.

We then determined the total crude oil sales of the Supply Department. We removed the sales which generate nonapportionable income; the remainder sales there are, therefore, sales of purchased crude oil. And in 1965 that would be $388,000,000.

The second computation is necessary for the cost of manufacturing weight over on Exhibit E-2.

Mr. Timken: Let's take five minutes. Short break.

(Recess 11:40 a.m.)

Q. Mr. Sheridan, I believe we have just turned to Exhibit E3.1?

A. Yes, sir.

Q. And will you proceed to explain that exhibit?

A. In 1965 we determined that crude oil and condensate sales of the E and P Department before eliminations—that figure is $584,000,000. We had previously determined that the nonapportionable percent of this crude oil is 55.9186, so we apply that percent against the sales and we arrive at a figure of $326,000,000 which we call "sales generating nonapportionable income."

We then determine out of the total sales of crude of the—out of the Supply Department, we remove those sales which produce or generate nonapportionable income, the remainder sales then must be of purchased crude oil, and that figure is $388,000,000, and that figure is carried over to Exhibit E2.

Q. Did you want to continue?

A. The figure of $326,000,000 is carried over to Exhibit E3.

Q. Does the percentage 55.9186, is that percentage computed on the barrel formula to which I asked you to refer at the beginning of your testimony?

A. Yes, it is. That is from the schedule furnished to me by Humble and I have it in my work papers as Page E4.1, it is Exhibit 11-6.

Q. And this procedure was used for all four years?

A. Yes, it was.

Q. Is your next exhibit Exhibit E4?

A. Yes.

Q. Would you explain that?

A. Exhibit E4 is the computation of the nonapportionable income or income which is not subject to apportionment. We have two types; first, we have income which follows the situs of the property, and we have income which follows the legal residence. The major item in 1965 is the itemization of the departmental nonapportionable income of natural gas in 1965 of $57,000,000 and crude oil net income of $101,000,000. That gives us a subtotal of income which follows situs of $178,000,000, and we add to that the income which follows the legal residence, namely dividend and interest income of $17,000,000, and this gives you a total or a gross nonapportionable income of $196,000,000, and to this we have made a minor administrative allocation and removed the federal income taxes therefrom, and then we—the result is total company nonapportionable income of $192,000,000.

Q. Did you previously refer to that figure in your testimony?

A. The apportionable income?

Q. Yes, of $192,000,000?

A. Yes, that would be on—yes, that would carry over to Exhibit C.

Q. Well, you don't have to refer to Exhibit C, but that $192,000,000 is a figure that is used to reduce the amount of taxable income, is that right?

A. Yes, it is, on Exhibit C we remove from total company income what we have determined as nonapportionable income of $192,000,000. It is almost half of the total company income.

Q. Turning next to your Exhibit E4.1, would you describe that?

A. Exhibit E4.1 is a computation of the adjusted net income for the Exploration and Production Department. In order to determine the net income attributable to crude oil and gas sold at the lease to third parties, we determined the net income of that department. We begin with a figure which is considered the factor of taxable income of that department. We have made adjustments, the principal adjustment is the removal of percentage depletion of $201,000,000, and we then arrive at what we have entitled an "adjusted departments net income" of $270,000,000. This would be the adjusted department net income for the entire E and P Department, and the same procedure was used in the other three years.

Q. Is the $201,000,000 the federal or state—the federal depletion?

A. Yes, it is, percentage depletion.

Q. Your next exhibit is Exhibit E4.2?

A. Yes, it is.

Q. Would you describe that?

A. Exhibit E4.2 is a computation of departmental—or E and P Department income attributable to natural gas and crude oil. In order to determine the income which is assignable to gas and crude sales at the well to third parties, we were required to use this method, since any one particular sale—the net income of that sale cannot be determined.

In 1965 we started with the sales of the E an P Department. We made a minor adjustment for an item which is specifically following situs. We are at an adjusted E

and P Department sales of $866,000,000. We have already previously determined the E and P Department net income of $270,000,000, so we determined the ratio of the net income to net sales, and in 1965 that is 31.1878 percent. We then take the nonapportionable sales in natural gas of $184,000,000 and we assign it the ratio of net income of 31.1878 percent to determine the net income attributable to those sales and that would be $57,632,000. We used the same procedure for the nonapportionable sales of crude oil of $326,000,000. We apply the same net income percent or ratio of net income to sales of 31.1878 and determine the income from the sales of crude oil of $101,000,000. Then the figures of $57,000,000 and $101,000,000 are carried over to Exhibit E4 as nonapportionable income, or income following the situs.

Q. The next exhibit is Exhibit E4.3?

A. Yes, Exhibit E4.3 is a computation af administrative allocation to nonapportionable income. We determined the ratio of the gross nonapportionable income of $196,000,000 to the adjusted net income as shown on Exhibit C of $413,000,000, which gives us a ratio of 47.362 percent. The selling and administrative expense within the administrative department was $970,000, and we apply the ratio of 47.3623 percent to that to determine the amount of selling and administrative expense which is attributable to nonapportionable income, and that figure is $459,000, and that again is carried over to Exhibit E4.

Q. The next Exhibit is Exhibit E4.4, is that correct?

A. Yes.

Q. Now what does that show?

A. This exhibit is a summary of the nonapportionable income to Wisconsin. In 1965 we have gains or losses of tangible property, which follows situs of that property of $102,000, and in this instance this happens to be loss. We remove federal income taxes to get a nonapportionable in-

come to Wisconsin of $100,000 loss, and that also is carried over to Exhibit—well it is carried over to Exhibit C, as a reduction of apportionable Wisconsin income.

Q. And the next exhibit is the last one entitled "Schedule 1."?

A. Yes, sir.

Q. What does that show?

A. This schedule shows the adjustment made to the reserve for bad debts. Humble Oil and Refining Company is on a percentage deduction basis for federal purposes. The Wisconsin Statutes do not allow this so Wisconsin allows bad debts on an actual basis. This schedule makes this adjustment from percentage deduction to actual.

In 1965 the net adjustment was $3,000,000.

Mr. Shapiro: I have no further questions at this time.

Mr. Timken: Mr. Ragatz?

Recross Examination

By Mr. Ragatz:

Q. Mr. Sheridan, you referred to a Page in Exhibit 11-6?

A. Yes, sir.

Q. Is that data you requested from Humble?

A. Yes.

Q. And Humble supplied you with what you requested?

A. Yes.

Q. In the form you requested it?

A. Yes. I assume it had to be. I asked for data, and this is the data they sent to me.

Q. And you didn't make any further request?

A. No, I assume—I think they made a statement in their letter that it is roughly similar to what has been furnished in the prior audits.

Q. You referred at Page E-2 of Exhibit 1 to the cost of manufacturing factor?

A. Yes, sir.

Q. Now, when you computed the cost of manufacturing for purposes of your weighting, you didn't use any cost of goods figure, did you?

A. Not in this instance.

Q. You used a sales figure, didn't you?

A. In lieu of any other information, yes.

Q. So really when you made your three-factor computation, you used two sales factors, didn't you?

A. No.

Q. Do you recall me questioning you under oath in January?

A. Yes.

Q. January 15th, to be exact, of this year, and were you testifying under oath at that time?

A. Yes, I was.

Q. Were you testifying truthfully?

A. Yes, I was, to the best of my ability.

Q. Do you recall me asking you on Page 60, "Question: So you didn't use any manufacturing cost figures in that determination? Answer: Cost is usually harder to obtain. Question: So your testimony is that you used sales figures in that determination? Answer: Yes. Question: And you also used sales figures in determining the sales factor? Answer: Yes, but they are used in a different manner."

Now, were these your answers at that time?

A. I believe you read them, yes.

Q. Now, on your Exhibit E-1.1, again on Exhibit 1 in this case, now, you employed the assumption that the net income percentage for all—excuse me, the net return on investment for all property investments were the same, didn't you?

A. The net return on investment?

Q. The percentage return on investment on all investment and property would be the same, isn't that an assumption used in that schedule?

A. That isn't the way I want to phrase it.

Q. Well, did you or did you not employ that assumption?

A. The assumption is that a dollar or net income has a relationship to the tangible property.

Q. But you were trying to divide the investment of property by the company into apportionable and non-apportionable property?

A. Yes, sir.

Q. And you took the net income percentage for the E and P Department and applied that to property to make that division, didn't you?

A. In lieu of any other method, yes, any other data, yes.

Q. And by applying that method you are assuming that each dollar of investment of property returns the same dollar of net income?

A. I am not assuming that.

Q. Well, do you deny that that is the assumption in this method? I can read you your testimony under oath from the deposition if you have forgotten that you talked about that in January.

A. We are attempting to—

Q. Just answer my question. Do you or do you not employ the assumption when you make that calculation that each dollar of investment of property has an equivalent—excuse me, an equivalent percentage of return?

A. I guess you could say that.

Q. Now, I turn to Schedule E-1.2 and on Line D that is one of the places in this formula application that you are taking a ratio times a ratio, isn't it?

A. Line D, yes.

Q. Now, in describing your application of the formula as Mr. Shapiro took you through the audit reports, you

were making a distinction between income of the E and P function derived from sales of crude and natural gas at the well head and income that you called apportionable because the crude was transferred to the refinery?

A. That is what we were attempting to do, yes.

Q. That is a complicated mechanical process to compute, would you agree?

A. I don't think that is complicated. It is a mechanical process.

Q. It took you quite a few pages to lay that out and quite a bit of time this morning to explain it?

A. To determine that income, yes, in this manner.

Q. Does the Statute say anything about the distinction of when a particular quantity of raw material ceases to be income allocable to situs or related to income allocable to situs as when it becomes apportionable?

A. I don't think so.

Q. That is a distinction that the Department has developed, isn't it?

A. Yes.

Q. Are there any published or prescribed rules or regulations that set forth that distinction and how you calculate that application?

A. Rules and regulations?

Q. Published and prescribed rules and regulations by the Department?

A. I don't think so.

Q. Are you familiar with the rationale or the application of the weighting procedure that you described in your direct testimony?

A. Yes.

Q. Where you take the cost, or supposedly take the cost of products manufactured and the cost of products purchased to arrive at your weighting?

A. Yes, sir.

Q. Now again we have already said that you didn't really use cost figures, you used sales figures?

A. Yes, we used sales figures.

Q. But I would like you to explain why you do that weighting and whether in doing so you are considering whether the company has a hundred per cent cost in its cost of sales. Doesn't the company pay for the goods it acquires and doesn't manufacture just as it incurs cost to manufacture?

A. Well, the factor in the statute is not cost of sales, it's cost of manufacture. And cost of manufacture does not include the purchase of completed products from vendors by Humble. And our factor is cost of manufacture. It's not cost of sales. So we are only recognizing Humble's cost of manufacture here and it happens to be only 61 per cent.

Q. But Humble incurs cost when it incurs products that it in turn sells?

A. Oh, yes.

Q. And how does your formula reflect those costs and why doesn't that enter into the weighting?

A. Because that's not your cost of manufacture.

Q. That's not cost of manufacture. Well, of course, you didn't use cost of manufacture either, did you; you used sales?

A. Well, first of all, this method was used in the prior audit.

Q. Is that an excuse or a reason?

A. It's one reason why I used it. Secondly, I don't know, I would think even if we had manufacturing data it would not vary from this much.

Q. Well, by making that statement aren't you assuming that the cost of sales for each dollar of sales would be the same percentage?

A. Cost of sales.

Q. The relationship between sales and cost of sales would be the same percentage if you are assuming that you use sales figures instead of cost figures and get the same result?

A. No. We would start with cost of sales, remove the cost of those purchases which you purchased and then add your own manufactured cost. We would have the same relationship.

Q. That's not the question. You said that you used sales figures, not cost figures.

A. Here. That's right, here.

Q. Now you wouldn't get the same result if you used cost figures unless the cost of sales percentage as a percentage of sales was exactly the same for each dollar of sales, would you?

A. No.

Q. So that by using sales figures you don't really get a cost calculation, do you?

A. It's basically the same.

Q. Not unless you assume that your cost of sales percentage is the same.

A. I don't know what you mean by cost of sales percentage.

Q. Well, I guess that's apparent that you don't know what I mean.

Let me ask you one more question on that. Why, when you are weighting, assuming now you tell me you understand the rationale, why don't you also weight these sales between those sales of products, goods manufactured and those sales of goods that were purchased?

A. Because the factor says sales.

Q. Well, the other factor says cost of sales, you didn't use that?

A. No, it doesn't say cost of sales; it says cost of manufacture.

Q. All right. But you didn't use cost of manufacture, did you?

A. I stated in lieu of cost of manufacturing data sales data was used. The result would be the same or almost the same.

Q. Well, if you assumed the same percentage in cost, do you have any information in your audit or any information that you can give me now that Humble's costs and its products are the same percentage per dollar of sales for every one of its products?

A. I don't think Humble has that data and I don't have it.

Q. Your answer is you don't have that data?

A. No, I don't.

Q. Now can you imagine a company the size of Humble having the same percentage cost in relationship to its sales for every one of its thousands of products?

A. It can't.

Mr. Ragatz: No further questions.

Mr. Shapiro: Any redirect, Mr. Shapiro?

Mr. Shapiro: Yes, sir. I just have one or two questions, please.

Mr. Timken: Well, let's get those in before lunch then.

Redirect Examination

By Mr. Shapiro:

Q. Mr. Sheridan, I call your attention to the provision of Section 71.07 (1) in these Statutes and I will read it in part: Income or less derived from the operation of any farm, mine or quarry shall follow the situs of the property. I have paraphrased that.

A. Yes, sir.

Q. Does that statutory language relate to the procedures that you used in your audit?

A. Yes, sir.

Q. Now if product is transferred from one department of a corporation to another department of a corporation, is it your understanding that that derives income for income tax purposes?

Mr. Ragatz: I am going to object to that as leading although I am reluctant to do so. I think if we are going to characterize what the statute says, first of all, the statute speaks for itself. But, secondly, if he wants the witness to interpret the statute, which he is not technically qualified to do, at least he should do it in his own words.

Mr. Timken: Both parties have been allowed considerable latitude and this isn't a court of record so we will overrule your objection.

The Witness: I better have the question then, please.

(Question read)

The Witness: No.

Mr. Shapiro: No further questions.

Mr. Timken: Anything further, Mr. Ragatz?

Mr. Ragatz: Yes, one question.

Cross-Examination

By Mr. Ragatz:

Q. Where in the statute, Mr. Sheridan, does that distinction appear?

A. Which distinction, please?

Q. The distinction Mr. Shapiro just asked you about.

A. Well, it said income from mines, I believe.

Q. In fact, it says income or less derived from a mine or quarry, doesn't it?

A. Yes.

Mr. Ragatz: No further questions.

(Witness excused)

Mr. Timken: Before we adjourn, Mr. Shapiro, now as I understand it from the game plan that has been submitted, you have two more witnesses coming.

Mr. Shapiro: That is the game plan, yes, Mr. Commissioner.

Mr. Timken: And you have one expert you are going to call this afternoon?

Mr. Shapiro: That's our intention, yes.

Mr. Timken: Very well.

Mr. Shapiro: Could I have the option of considering having our second witness on either Friday morning or Thursday afternoon so that transcripts could be made available to him? We are running ahead of schedule and we were scheduled for Thursday and Friday and we planned our work accordingly. Two days were allotted to us.

Mr. Timken: Mr. Ragatz?

Mr. Ragatz: That causes me some problems because I, of course, have the opportunity for rebuttal and I don't want to keep my witnesses here an extra day or so; and, also, I would run into some problems with timing on Friday.

I am happy to let him have Mr. Keesling testify tomorrow instead of this afternoon even if there is time this afternoon. I do understand that he is in town currently, that he came in to town last night.

By the fact that my client is paying for it, Mr. Shapiro has the transcript at the same time we do which is about 7:00 o'clock in the evening. Now if Mr. Keesling hasn't yet read the transcripts to date, he should get going doing it. And certainly today's transcript will be ready by 7:00 o'clock this evening. And I don't see of any reason in the world why he couldn't testify first thing tomorrow morning.

Mr. Timken: Mr. Shapiro, let me ask you this. Is your first witness going to be lengthy; is it going to be long?

Mr. Shapiro: Not our presentation will not be long. In terms of long, do you mean more than two hours?

Mr Timken: Well, in terms of long, more than two hours.

Mr. Shapiro: I don't believe so, sir.

I would like to mention, regarding Mr. Ragatz' comments, that we have made an effort to cooperate yesterday in speeding up the process by putting on two witnesses ahead of schedule.

Mr. Timken: You did and that was appreciated.

Mr. Shapiro: And we would appreciate cooperation in return.

Mr. Ragatz: I don't mean to be uncooperative but I sure don't want to keep all these people here Friday if we don't have to.

Mr. Timken: Well, our primary aim was to conclude this matter this week and it looks like we can accomplish that. I would hope, Mr. Shapiro, that you can conclude your case tomorrow, no later than tomorrow.

Based on what you are telling us I think Mr. Smrz and I both agree we would be reluctant to hold it over 'til Friday because then the rebuttal might take us on beyond that period. Is it possible for you to conclude your case tomorrow or can't you answer that question?

Mr. Shapiro: Could you make it tomorrow afternoon, sir?

Mr. Ragatz: Then if we are going to have rebuttal that would put it over maybe to Friday and then I am keeping my people over.

Mr. Timken: Is your witness here?

Mr. Shapiro: Yes, sir.

Mr. Timken: What's the problem then?

This doesn't have to be on the record.

Let's go off the record.

(Discussion off the record)

(Noon recess, 12:00-1:30 p.m.)

Afternoon Session 1:30

Mr. Shapiro: You may proceed with your witness.

FRED C. ALLVINE, called as a witness, having been first duly sworn under oath, testified as follows:

Direct Examination

By Mr. Shapiro:

Q. Will you please state your full name and address for the record?

A. My name is Fred C. Allvine, A-l-l-v-i-n-e. I live in Dunwoody, Georgia, a suburb of Atlanta.

Q. What is your present occupation?

A. I am an Associate Professor of Marketing in the College of Industrial Management at Georgia Institute of Technology.

Q. And will you briefly describe your educational background?

A. Yes. I obtained a Bachelor Degree from Kansas University, a Master's Degree from the Harvard Business School, and a Doctorate from Indiana University.

Q. I would like to have you specify, Mr. Allvine, what field these degrees are associated with?

A. These degrees were in the area of business management.

Q. Now you have stated that you are a Professor of Marketing. What does that subject matter deal with?

A. Marketing is an implied arm of economics. It is concerned with the planning, promotion, distribution and merchandising of products and services.

Q. Do you consult in the area of marketing?

A. Over the years I have consulted in a number of capacities in the area of marketing management. For a period of four or five years until recently, I taught in a monthly marketing management seminar for an organization called Advanced Management Research. This seminar was directed to vice presidents of marketing and marketing planners responsible for often times multi-million dollar operations.

In addition, I have consulted for oil companies; I have consulted for integrated oil companies; I have consulted for independent refineries, and I have consulted for independent marketers.

Q. Have you published papers and academic journals?

A. Yes. I have published a number of articles on marketing and on the petroleum industry. These have appeared in *Business Horizons, The Journal of Marketing, The Business and Society Review,* and the *Proceedings of the American Marketing Association.*

Q. Have you edited any books?

A. Yes, I have edited two books. One was *The National Proceedings for the American Marketing Association,* and I edited and contributed to the proceedings for a conference concerned with public policy in marketing that I was chairman of for the American Marketing Association.

Q. Have you written any books?

A. Yes, I have written two books.

Q. Please name them.

A. The first book was published in 1972 and was coauthored with Professor James Patterson of Indiana University, and this book was entitled *Competition Limited: An Analysis of the Gasoline Industry,* and then this past week I had a second book—or the past couple of weeks I had a second book that became available on the gasoline and petroleum industry, and I believe it was entitled *"Highway Robbery: An Analysis of the Energy Crisis."*

The first book, *Competition Limited,* was concerned with the marketing of gasoline by integrated petroleum companies involved in the functions of production, refining and marketing, as well as independent refiners, marketers and producers. This book focused on the structure of the petroleum industry and economics in the petroleum industry, which I think is very germane to the subject we are addressing here.

Q. Do both of the books deal with gasoline marketing?

A. They both deal with methods and procedures of gasoline marketing and the structure of the petroleum industry and the relationship between marketing and the refining and the production end of the petroleum business.

Q. Has the petroleum business been a specialty of yours?

A. Yes. It has been my primary area of research for the last six or seven years. I have spent most of my time in doing research and preparing papers and analyzing this industry.

Q. Was the research for these books supported by any organizations?

A. In part, the research was supported by some outside organizations; the first book, *Competition Limited: An Analysis of Gasoline Mraketing,* was sponsored by an initial research grant from an organization called "Sigma," S-i-g-m-a, which was the trade association for the largest group of independent discount gasoline marketers. It is made up of such companies as you see in Wisconsin, like Martin Oil Company, Hudson, and others that have specialized primarily in the function of gasoline marketing.

The second book, *Highway Robbery: An Analysis of the Energy Shortage,* was primarily sponsored by a group called the Council of Independent Gasoline Marketers. The Council was made up of approximately a dozen and a half of the largest of the independent discount gasoline marketers, and members of that group also include Martin Oil Company and Hudson that operate within the State of Wisconsin.

The Northwestern University similarly supported the original grant and made available time for me to work on that study.

Q. Have you addressed any groups on the subject of the oil industry?

A. Yes, sir. I have over the last four or five years perhaps given a dozen or more speeches about the structure of the petroleum industry, the economics of the petroleum industry, and these have been before the National Association of Independent Gasoline Marketers, before the National Oil Jobbers Council representing the major trade association of the branded jobbers of the major oil companies.

I have given several speeches before the local State Association of Independent Gasoline Marketers. I have also spoken before Oilmen's Club that represents the major oil companies and their primary field activities.

Q. Have you testified before committees of Congress?

A. Yes, sir. Over the last four or five years I have testified before different committees of Congress perhaps on a dozen of occasions. I have appeared before the Senate Anti-trust Committee, I have appeared before the Senate Small Banking Committee, I have appeared before the Interior Committee, I have appeared before the Joint Economics Committee of the House and Senate, and I have appeared before the House Small Business Committee, and there is six to one right now that I can't recall.

Q. Have you appeared before the Senate Investigating Committee?

A. Oh, yes, I appeared before the Senate Investigating Committee this last year and gave testimony concerning the structure of the petroleum industry and energy shortage.

Q. Have you testified in court as an expert on the petroleum industry?

A. I have, yes, testified in four lawsuits relating to the petroleum industry and also advised in a lawsuit that was settled before going to court.

One lawsuit involved a dealer that was suing the American Oil Company. In that case I testified on behalf of the

dealer concerning the question of price zones and the availability of price supports through the dealer.

In a second lawsuit I testified on behalf of the Blue Chip Stamp Company that was being sued by a division of the Continental Oil Company called Douglas and discussed and presented expert testimony about the structure of the marketplace competition.

A third lawsuit that I testified in pertained to the nature of the economic structure of the petroleum industry. It was Consumers out of, I believe, Trenton Consumers, which was a Phillips jobber that was being sued by the Phillips Petroleum Company for being cut off of the source of supply, and I appeared on behalf of the jobber.

The fourth lawsuit was the case of Romaco out of Montgomery, Alabama, and this was an independent brand dealer such as Hudson or Martin that had lost their source of supply, and I was testifying as to the difficulties that this company was confronted with.

In addition I counseled in another lawsuit for a petroleum company which was a small integrated company—not too small, which was Pennzoil United, and I testified on behalf of Pennzoil United in a suit brought by the dealer against the company.

Q. Have you consulted with any government committees?

A. Yes, I have consulted for the Senate Investigating Subcommittee. I was on leave from Georgia Tech in the third quarter of 1973 for three months where I acted as the chief economist for a study done under the Senate Investigating Committee chaired by Senator Henry Jackson into the causes of the product shortages of 1972 and '73.

I have voluntarily counseled with several other agencies of the federal and state government without compensation as they have called to ask me questions or asked me to stop

in and visit with them on several occasions in Washington, D. C.

In addition, I forgot I was appointed to the National Gas Task Force study which was published last year, and I was a consultant to this committee concerning the distribution of natural gas in the United States.

I also was a consultant to a group that was advising the Federal Trade Commission in terms of the mandatory allocation of fuel products that went into effect in early 1973.

Q. Did you consult with a subcommittee for the Irvin Government Operations Committee?

A. Yes, that was the one chaired by Senator Jackson's subcommittee, and this committee issued a major report on the cause of the petroleum shortage in November, 1973, and I was one of the co-authors of that study, and I testified at length about the findings of that study in hearings before the Investigating Committee in the final part of 1973.

Q. As a result of your work as an economist with Senator Jackson's Committee, were your findings covered by the media?

A. Yes, the television networks—I believe all of them—interviewed me and ran programs expressing the findings and views that I had developed. In addition, several of the newspapers carried accounts of the analysis that I had made of the petroleum industry including such papers as the *New York Times,* the *Chicago Tribune* and several others.

Q. Approximately when were you first contacted by the Department of Revenue in connection with this litigation?

A. I would say—I can't pin it down, but we have had numerous contacts, and it could have been six months to a year ago when I was first contacted by the Department of Revenue of Wisconsin, and then since that time I have met in sessions, extensive—one extensive session, and have

had several documents sent to me and had numerous telephone conversations concerning these documents and the progress that was being made in this lawsuit.

Q. Was one of the conferences held in Atlanta, Georgia?

A. It was, sir.

Q. Dr. Allvine, will you briefly review the major types of petroleum companies?

A. The major types of petroleum companies which make up the structure of the petroleum industry I think can be very simply described and have been gone over time and again, so I will quickly do that.

The major type of competitor is the vertically-integrated petroleum company which has extensive operations in the exploration and production of oil and refining of oil and in marketing of gas, and other petroleum products.

These companies that fall into this classification would include Exxon, Texaco, Mobil and many other national or extensively marketed brands of gasoline.

Then the industry beyond that is broken into independent segments, companies that specialize primarily in the marketing of gas, companies that specialize in the refining of gas, or companies that specialize in the production of crude oil, and the third major categories of companies are those that operate in two primary functions. We have some companies that are involved primarily in the marketing of gasoline and the refining of gasoline.

The categories which I described are very similar to those that Mr. Luper presented in one of the earlier documents submitted in this case.

Q. I take it then that you have heard all the testimony and seen many of the documents thus far presented in this proceeding?

A. That's correct.

Q. Now, with respect to the testimony and evidence presented regarding the reliability of posted field prices, I

would like to ask you how the posted field price relates to the matter of functional profits of the departments of an integrated oil company which were all extensively covered in this proceeding?

A. The posted field price is not a marketed price. It is one which in economic terms we refer to as an administered price, and an administered price is one that is not set by the free workings of the marketplace of buyers and sellers coming together, and through the pressure of the marketplace establishing the price at which oil is sold.

The posted field price is established by the joint interest of the vertically-integrated oil companies that produce approximately in this period of time two-thirds of the oil.

Mr. Ragatz: I object at this point. The witness has just testified through an anti-trust conspiracy and that the posted field prices are set by—

The Witness: Administered prices are not—

Mr. Ragatz: You be quiet. I want to remind the Commission that this is not an anti-trust case. The issues in this case are tax issues, not anti-trust issues, and I would like the Commission to instruct this witness to limit his answer to questions propounded on tax matters and to stay out of anti-trust areas, and I will continue my objection if this witness continues to venture into anti-trust areas.

I feel it is beyond the realm of the jurisdiction of this Commission and certainly irrelevant to the issues in this case and has no place in the testimony in this record.

Mr. Shapiro: May I comment? Dr. Allvine has an extensive knowledge of the petroleum industry as borne out by his qualifications. To exclude his testimony because he has done anti-trust work and where the questions are most relevant to unitary issues would be a gross injustice.

If his expertise has resulted in his being retained to work in anti-trust cases, this should not affect his expertise

to testify regarding the organization and structure of an integrated petroleum company such as Humble; and I would add that the matters covered are most relevant to the unitary issue.

The respondent urges as a basic premise for its position that the functional profits as accounted for by the company are not the significant profits for Wisconsin income tax purposes, but that the overall or total profits of the company represent the important factor, and these are the prices at which products are transferred either to third parties, outside third parties, or to other departments within the company.

Now, Dr. Allvine is a recognized expert in the field of oil and gas marketing, and the fact that he has this expertise and has utilized it in other types of litigation should not influence his testimony on relevant matters pertaining to the unitary issue.

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: I submit I am not objecting to the presentation of the respondent's case, and if the respondent wants to present the case that the overall profit of the company is what is important rather than the functional profit, I have no objection to that, but the answer that I objected to here had clear anti-trust ramifications. The witness testified that the posted field prices were to result in an effect on a conspiracy—

Mr. Shapiro: He did not.

Mr. Ragatz: He did not use the word conspiracy, but the import of this word was here. I not only want to object, but I ask that the answer be stricken from the record and the witness be instructed not to venture into anti-trust matters.

If counsel wants to present his case on the overall profits, he doesn't have to get into anti-trust matters.

Mr. Shapiro: May I comment?

Mr. Morris: Wait until Mr. Ragatz is through.

Mr. Ragatz, you may finish.

Mr. Ragatz: Okay.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: An extensive part of petitioner's case relates to the reliability of the posted field price that has been made an issue in the proceedings. I submit that Dr. Allvine should not be precluded from rebutting such testimony, if that is his testimony.

Mr. Morris: This case involves the taxation regarding a certain period of time in the State of Wisconsin. The testimony should relate to the years in question, for the years in which the question has to be answered and the issue resolved. Second, that if the witness has been in court during the testimony, I assume he would be familiar with the testimony given and with some of the exhibits presented and so forth as he has testified he has. And I would like the questions and the testimony to relate to this issue and to the years in question. I will allow you to continue, Mr. Shapiro, in your line of questioning and at the time I feel that the questions that are being asked and the answers that are being responded to no longer have any relevancy to the question in issue, and that is the taxation matter before us, I will then ask counsel to appear before me in chambers and take the question from there. But at this time I will allow—but again specifying that the questions and answers should relate to this hearing and the times in question and to the issue of this hearing.

You may proceed, Mr. Shapiro.

Mr. Shapiro: I would like to know what the last question was.

(Question read)

Mr. Shapiro: I would like to instruct the witness to confine his comments to the period 1965 through 1968.

Mr. Morris: And regarding—

Mr. Shapiro: And regarding the unitary issue in this matter.

Mr. Morris: And regarding the company Exxon.

Mr. Shapiro: And regarding the company Exxon or Humble in those years.

Mr. Morris: Can you answer that?

The Witness: Yes, I can.

Mr. Morris: You may proceed.

The Witness: There has been—

Mr. Ragatz: I am going to object right away. There has been no foundation that this witness knows anything about the practices of Humble Oil and Refining Company; and there is absolutely no foundation and this witness should not be permitted to testify one word about that company without foundation.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: Have you studied and researched—

Mr. Morris: Are you withdrawing your question now to lay a foundation?

Mr. Shapiro: I asked the witness in regard to the functional operations of an integrated oil company such as Exxon or Humble.

Mr. Morris: Exxon or Humble.

And you have an objection that the foundation has not been laid in which this expert witness can testify as to the company or the Exxon Corporation or formerly Humble Oil Company.

At this time I would have to say that some foundation has to be laid as to what expertise this man has regarding Exxon or Humble at the time. I don't think there has been any foundation that Exxon is an integrated or the type of oil company he is going to testify to.

Mr. Shapiro: Sir, he is testifying as an expert witness; and the statutes permit a very broad interpretation of the Rules of Evidence relating to the testimony of experts.

His qualifications show and his studies have been confined to major integrated oil companies of which Humble and Exxon are the largest.

Mr. Ragatz: Mr. Chairman?

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: I submit that when this type of testimony is requested on the industry itself it can only relate to anti-trust and that the question, if it can be asked, has to be asked specifically as to Humble; and that there has been no foundation whatsoever that this witness knows anything about Humble Oil and Refining Company. So I renew my objection and ask for a ruling on it.

Mr. Morris: Well, again, Mr. Shapiro, I would suggest that you ask questions regarding Exxon and Humble that's before us today; and I further request that if the person does have knowledge of Exxon and Humble, that he be classified as an expert along those lines.

I will let you continue your line of questioning and I will reserve ruling on Mr. Ragatz's motion pending your series of questions.

Mr. Shapiro: Thank you.

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: Mr. Commissioner, if you are not going to rule on my foundation objection I wonder if you have given me the latitude to voir dire of the witness at this time to see if he does know anything about Humble Oil and Refining Company.

Mr. Shapiro: I will object to that.

Mr. Morris: Let's go on with the hearing, gentlemen. Mr. Shapiro, I will reserve Mr. Ragatz's ruling. Mr. Shapiro, would you continue your questions?

By Mr. Shapiro:

Q. Has your study and research in a self-specialized field to which you have referred covered the activities of Humble during the years 1965 to 1968?

A. Yes. In preparation for this proceeding I have reviewed documents relating to the Humble Oil Company audit; I reviewed documents that have been presented by Humble Oil Company; I have studies more broadly the petroleum industry involving Exxon and their stations and their operations during the period covered from '55 to '68.

I, furthermore, have heard the extensive testimony about the way in which the posted field price has been established from Mr. Luper and at least four other people that talked generally as well as—that talked generally about the posted field price. Furthermore, I have had contact over the year with different people directly and indirectly as it relates to Humble's operation.

Q. Now do you remember—

Mr. Ragatz: Objection. If that's a foundation for him being able to talk about the internal practices of Humble, then I am goofy. This witness—I would really like an opportunity to examine this witness at this time on voir dire to find out whether he really knows anything about the internal operations of Humble. And certainly he cannot be permitted to testify here as to vague conversations which are undoubtedly hearsay and as to vague studies in the industry. So he has reviewed the audit, or papers and the documents here in evidence. That doesn't qualify him as an expert.

Mr. Shapiro: I submit we are talking about the posted field price which has been extensively covered up to this point and petitioner's case. The posted field price is broad, wide—has a broad, wide application and scope. It's a concept, a device that is used industry-wide. And if this expert witness under the Rules of Evidence cannot testify regarding that concept, then he is being unduly restricted.

Mr. Morris: Mr. Shapiro, he is not being unduly restricted in any sense. The question I have to find out and the Commission, is if he is an expert, does he know the

workings of Exxon and Humble during this period of time. And I think I will allow you to continue your line of questions, lay your foundation in which to determine whether he has the adequate knowledge and sufficient expertise after the foundation is laid in which to present the knowledge as an expert.

You may proceed. He talks about documents, he talks about a number of things. I don't know if these documents are the exhibits here or what they are. So if you will please continue and lay your foundation as to the expertise of this witness, I would allow you to continue. Reserve ruling on Mr. Ragatz's motion.

Mr. Shapiro: All right.

If I may divert for a moment, Commissioner, and read for you the substance of Rule 907.02, Testimony by Experts from the Wisconsin Rules of Evidence.

If scientific, technical or other specialized knowledge will assist the tryer of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education may testify thereto in the form of an opinion or otherwise.

We submit that the witness is an expert in the petroleum industry, that he has extensive knowledge regarding posted field prices as previously covered extensively in the testimony by petitioners and he should be able to relate what his studies show regarding the posted field price.

Mr. Ragatz: I would like to be heard.

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: I am familiar with the Statute that is cited by counsel; but I am also familiar with the facts that the Wisconsin Code of Evidence has not thrown out the rules that you have to lay a proper foundation before you can have any kind of testimony and particularly expert testimony.

Now the question, as I understand it, that has been propounded relates to Humble Oil and Refining Company during the years in issue. And I would like to renew my objection that there has been no proper foundation laid to indicate that this gentleman is an expert and can give opinion evidence as to the activities of Humble Oil and Refining Company during the years in issue.

Mr. Shapiro: It was my understanding, Mr. Commissioner, that you ruled that the witness could answer the question that was read a few moments ago.

Mr. Morris: I indicated, Mr. Shapiro, that you could continue your line of questioning and lay a foundation regarding the expert witness, regarding the years in question, regarding Exxon and the tax issue before us today. And I will allow you to continue that line of questioning. I will reserve ruling on Mr. Ragatz's motion.

You may proceed.

Mr. Shapiro: Thank you.

By Mr. Shapiro:

Q. Professor Allvine, would you state what your research and study and experience has been in regard to the Humble Oil and Refining Company for the period 1965 through 1968?

A. For the period 1965 to 1968 I have reviewed the financial statements of Humble, I have reviewed the working papers of Mr. Sheridan which gives a great deal of data about the Humble Oil and Refining Company. I have, in addition, studied the submissions of the petitioner relating to Humble Oil and Refining Company's operations during the period of 1965 to 1968.

I have further detailed knowledge and subscribed to the Platt's Oilgram which gives the posted field prices which the petitioner's witnesses have testified to which is the basis on which Exxon and other companies, according to the testimony given here in this court do establish the

posted field prices at which they transfer product from their supply to—from their E and P to their refining operations. These are standard rules and regulations which are followed as according to the gentleman for Arthur Andersen by all of the petroleum companies as prescribed under the federal statutes, tax laws as they relate to the depletion allowance.

Q. Now outside the scope of the materials that relate directly to the case in court here today, outside of those materials, has your study, training and experience in the specialty to which you have referred, touched upon, covered or related to the operations, activities of Humble Oil and Refining Company during this period in question?

A. Yes, sir. In the book that I did, *Competition Limited*, in that book I traced the market share of Humble Oil Company during the period in question including the years 1965 to 1968. As I prepared that study I reviewed the statistics regarding Humble Oil and Refineries, marketing operation, number of stations and crude oil self sufficiency.

Q. Now you have heard testimony in this case and you have seen documents relating to the accounting methods used by Humble in recording their profits by function or by departments. Now how does the posted field price relate to this matter?

Mr. Ragatz: I take it counsel is now through trying to lay a foundation, and I have still to hear that this witness has a sufficient foundation to answer questions directly relating to Humble Oil and Refining Compay.

I would like to point out, which counsel seems to have overlooked and which obviously the witness has overlooked, that the examination of Mr. Sheridan's audit would, by Mr. Sheridan's own admission under oath on the record, reveal absolutely nothing about the organizational structure of Humble Oil and Refining and its transfer prices

because Mr. Sheridan testified under oath that he didn't examine either one of these things.

Without that, there is still no foundation here for this man to testify as to the internal operations of Humble Oil and Refining Company, and I want my objection renewed on the record.

Mr. Shapiro: The implication is that in order to have an expert witness, we must have a man that worked for Exxon, it appears, and I submit that that should not be the case.

Mr. Morris: I will allow the witness to answer the question subject to the objection of Mr. Ragatz.

You may proceed.

The Witness: I truthfully have forgotten the nature of the question. If it is possible for you to restate it in a simple form—

By Mr. Shapiro:

Q. How does the posted field price relate to the matter of department profits as accounted for by Humble during the years in issue?

A. The posted field price is a price which is established not by the free workings of the marketplace, not through the—

Mr. Ragatz: Objection; anti-trust.

Mr. Morris: Mr. Shapiro, again I am going to have to limit you to say, "Does it apply to this case," and this question cannot be broad. It is going to have to apply to this case.

Mr. Shapiro: Sir, the posted field price has been extensively covered as to its reliability.

Mr. Morris: The posted field price regarding Exxon involved in the year in question relating to this case—

Mr. Shapiro: I will rephrase the question.

Mr. Morris: You may proceed.

By Mr. Shapiro:

Q. Does the posted field price or posted field prices relating to Humble during the years in issue relate—do those posted field prices, as testified to by witnesses for the company, constitute a free market price?

Mr. Ragatz: Same objection.

Mr. Morris: We will take a ten-minute break.

(Recess)

Mr. Morris: On the record. Mr. Shapiro?

Mr. Shapiro: Following Mr. Ragatz' objection, I would like to rephrase the question, if I may.

Mr. Morris: You may proceed, Mr. Shapiro.

By Mr. Shapiro:

Q. Based on your expert knowledge, how were the posted field prices by which Humble trasferred its products during the years in question established?

Mr. Ragatz: Same objection. There is no foundation for how this witness could know how Humble established prices.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: I submit that his background clearly qualifies him to answer that question. It is an area in which—

Mr. Morris: In what way does his background qualify him to answer the question?

Mr. Shapiro: He has done extensive study and research in—with respect to the petroleum industry and with respect to this specific matter of posted field prices.

Mr. Morris: I think the testimony as to some of his expertise and some of his background has been of recent origin. I am again wondering what his expertise is in the year '65 through '68.

Mr. Shapiro: He has testified he has studied these matters during the period in issue.

Mr. Morris: He testified to the fact that he studied some documents and reviewed—I don't know what documents he studied or some of the other things—I assume the documents you are talking about are the exhibits, but I don't know.

Mr. Shapiro: He has mentioned several inquiries outside of the documents involved relating to this case.

Mr. Ragatz: Nothing specific, or I want to know what they were so I can find out if they are hearsay.

Mr. Shapiro: I will ask the witness:

By Mr. Shapiro:

Q. What studies have you made covering the subject matter of posted field price with respect to the years 1965-1968?

A. May I answer that?

Mr. Morris: No one is objecting, so—

A. I have studied for the years 1965 to 1968 the Platt's Oilgram price service which has been referred to on innumerable occasions as the basis by which reference is established by the companies relative to the posted field prices, a service that comes out with the exception of holidays, on Monday through Friday; this is the same field price which we have heard testimony about that all of the companies, including Exxon, referred to. It is the price by which the federal tax authorities establish should be used for the determination of the depletion allowance, and it is the means by which all companies including Exxon, as direct testimony has been given in this room, proceed to establish for tax purposes and for transfer prices within the integrated petroleum companies, crude oil from their refining operations.

Mr. Ragatz: Mr. Chairman, I would like to point out that I don't disagree with what the witness has said. That is just a recitation of testimony here today, but that is not

foundation for any knowledge he has as to Humble's practices.

I would like to point out one thing and maybe we can get off of this whole subject. If it is the position of the respondent now to challenge the integrity of posted field prices, perhaps I should remind him or the Commission should remind him that the entire audit was made premised upon the prices, the E and P price determined internally by Humble and based upon posted field price.

The whole calculation in the audit starts with that point, so that if counsel now wants to pull the rug out from under that, he is pulling the rug out from under his own audit, and I don't think he really wants to do that, but if he does, then it is clear that the motivation is anti-trust motivation and not tax motivation because he is destroying his own assessment.

Mr. Morris: Mr. Shapiro, do you wish to respond to that?

Mr. Shapiro: I do not concede at all that our case must rest upon the validity of the posted field price, but there has been considerable testimony involved as to the reliability of the posted field price and this witness is eminently qualified to give his views on the posted field price; and one of the matters that I have asked him to cover is that particular subject.

Mr. Morris: You may proceed, Mr. Shapiro.

Mr. Ragatz: Let the record note, for the record, that I am requesting that this inquiry be confined to those posted field prices used by Humble during the years in issue. If this witness has any information that those posted—those particular posted field prices were not fair market prices as has been already conceded by the several witnesses for the respondent, then this witness can testify to it if he has personal direct knowledge.

If he doesn't have personal direct knowledge, he is not qualified to testify to that, and I would object to any such testimony.

Mr. Morris: Mr. Shapiro, you may proceed.

By Mr. Shapiro:

Q. Mr. Allvine, do you have direct knowledge with respect to the validity of the posted field prices relating to the years in issue and with particular reference to Humble Oil and Refining Company?

A. Yes, I think I do.

Q. Would you please so state?

A. The posted field price, according to—

Mr. Ragatz: Objection. I still don't think we have a foundation. If he wants to state the basis of his information so that the Commission can intelligently make a ruling as to whether he has a foundation, that would be the next step.

By Mr. Shapiro:

Q. We are inquiring as to your knowledge—the acquisition of your knowledge and how you acquired it?

A. I acquired, first, general, and then specific, and if I am allowed to comment, not to just background where I have obtained the information and knowledge about the means by which the posted field prices are established—first, in terms of the general knowledge with regard to what the posted field prices are, I obtained this information from subscribing to and reading and analyzing the Platt's Oilgram price service which is used by Exxon as well as all other companies for establishing the integrity for federal income tax purposes of the posted field price.

Furthermore, I have studied the Platt's Oilgram document submitted in this courtroom which show the Exxon posted field price, and that is the only document that they have directly introduced that shows the posting of this

price; and I am familiar with that document and I have studied that document and I understand the tax basis for which the posted field price is established.

Furthermore, they have submitted information on the posted field price for the years 1960 to 1970 which is a document in issue. I studied that and the nature of those prices, and I am also prepared to testify about that.

Mr. Shapiro: Can the witness testify, Mr. Morris?

Mr. Morris: I am not saying anything. You are asking the question.

Mr. Ragatz: I would like to be heard. As far as I am concerned, the witness has not responded to the question of where his personal knowledge is, personal direct knowledge is as to the posted field prices actually used by Humble.

Mr. Morris: He has indicated, I think in the testimony, that it was Platt's—

Mr. Ragatz: I would like the opportunity to examine this witness here at this time and find out whether he has sufficient background to lay a proper foundation for opinion evidence, and I don't think we are going to get to that point until somebody examines him on that subject.

Mr. Morris: I will deny your request, Mr. Ragatz.

Mr. Shapiro, you may proceed.

By Mr. Shapiro:

Q. Are there any additional sources that you have not related?

A. No, sir, that is the primary source.

Q. That is the primary source?

A. Yes.

Q. I would like to ask you, is there any difference between—again with reference to Humble and with reference to the years in issue, is there any difference between the accounting for tax purposes and accounting for financial purposes?

Mr. Ragatz: Objection. This witness is an expert accounting witness.

Mr. Morris: I don't think there has been any testimony as to his accounting background.

Mr. Morris: Mr. Shapiro?

By Mr. Shapiro:

Q. Would you state your background on this subject?

A. Yes, sir. In the book *Competition Limited: An Analysis of the Gasoline Industry,* I discuss at some length the depletion allowance and the nature of the depletion allowance and the basis by which it is established, and in that book—for that book we reviewed accounting procedures relative to the establishment of the depletion allowance as were presented by a major accounting tax reference guide used in the petroleum industry.

Mr. Ragatz: I submit to the Commission that that certainly doesn't qualify him as an expert accounting witness. He has not stated he is a certified public accountant. He has not stated that he studied any accounting, that he has practiced any accounting, that he has had any particular accounting experience other than maybe he read somebody else's services. If that qualifies him as an expert to give opinions on accounting matters, then I guess we are all experts.

Mr. Shapiro: You have heard the testimony of—

Mr. Ragatz: Just a minute. Are you going to rule on my objection?

Mr. Morris: I am waiting for him to respond.

Mr. Shapiro: I am going to move to another question. Withdraw the question.

By Mr. Shapiro:

Q. You have heard the testimony of the petitioner's witnesses that none of Humble's gasoline, as asserted, came from Humble's E and P and refining facilities into

Wisconsin, and that Humble's Wisconsin operation was an independent—that Humble was independent in its refining and E and P activities. Do you agree?

Mr. Ragatz: What is the foundation for this witness' knowledge of Humble? I will have to object on that basis.

Mr. Shapiro: This witness is an expert in the petroleum industry, in the operation and structure of the petroleum industry.

Mr. Ragatz: The question was specifically as to Humble. We still haven't questioned this witness' background as to Humble.

Mr. Shapiro: He has heard all of the testimony presented with respect to the Humble operations.

Mr. Ragatz: So have you and I.

Mr. Shapiro: He should be permitted to relate his experience and background to that testimony.

Mr. Morris: Were you here during the entire testimony of this matter?

The Witness: Yes, I was.

Mr. Morris: Then at this time I direct that counsel appear before me. We will adjourn to the next room and we are off the record.

(Discussion off the record)

(Last question read back by reporter)

Mr. Morris: Is that the question?

Mr. Shapiro: Yes.

Mr. Morris: Do you understand the question?

The Witness: Yes, I do.

Mr. Morris: Based on the question do you have an opinion?

The Witness: Yes, I do.

Mr. Morris: Mr. Shapiro, you may proceed.

By Mr. Shapiro:

Q. What is your opinion?

A. My opinion is that Humble's Wisconsin marketing operation is not independent of its refining and E and P and Marketing operations outside of the State of Wisconsin. We have had an exchange agreement submitted as evidence, and that exchange agreement was the basis upon which Humble was able to obtain products from others on an exchange basis in the State of Wisconsin.

Were it not for Humble's refining and E and P outside of the State of Wisconsin, this exchange agreement could not have been developed, and the products would not have been obtained in the State of Wisconsin by Humble; so, therefore, in my judgment this supply that Humble has obtained in Wisconsin is related to their activities outside the State of Wisconsin, to their marketing, refining and E and P.

Q. Do you have direct knowledge aside from what you have heard in this case as to Humble's refining activities during the years in issue?

A. Yes, I do.

Mr. Morris: Where?

Mr. Shapiro: Refining activities in the United States.

Mr. Morris: Okay.

The Witness: Yes, I do.

Q. And will you state what that is?

A. This knowledge was presented by documents that showed the location of Humble's refining. It was also presented in the work papers by—

Q. I asked you aside from the materials presented in this case, did you have knowledge as Humble's—direct knowledge as to Humble's refining activities?

A. Yes, I have reviewed Humble's refineries and their capacity operations for the entire period of the 1960's relative to other research that I have done on Humble's operations.

Q. Was Humble's marketing operation in Wisconsin during the years in issue dependent in any way upon Humble's refining operations outside Wisconsin?

Mr. Ragatz: Same objection; no foundation.

Mr. Morris: You may answer if you can.

A. I have already testified that it is my judgment that Humble's marketing operation is dependent upon Humble's refining and production operations outside the State of Wisconsin, that the existence of this refining and production permitted the Humble Wisconsin operation to exchange products on exchange agreements that were based upon other activities of Humble's operation outside the State of Wisconsin.

Q. Do you have direct knowledge outside the testimony presented in this matter or the documents presented in this matter as to Humble's E and P activities during the years in issue?

A. Yes, sir. As part of my review of Humble's operation I have not only analyzed data relative to the refining capacity, but I have also analyzed data relative to their production of crude oil.

(Exhibit number 36 marked for identification)

Q. Your attention is directed to Exhibit number 36 and I ask you whether you prepared that exhibit?

A. Yes, sir, I did.

Q. And will you identify what it purports to show?

A. What this document shows is the relationship of Humble's crude oil production to its refining capacity.

Mr. Ragatz: All right. At this point I am going to interpose the anti-trust objection. This has nothing whatsoever to do with the tax case. This is clearly anti-trust oriented. It has no part in this case, and I strongly object to its inclusion in the record and to this witness expounding on the record as to anything related to this subject.

Mr. Morris: Mr. Shapiro, can you respond to that?

Mr. Shapiro: I submit that this is most relevant to the unitary issue involved in this case because it shows the relationships, and that is basically what the State is trying to show in this case, the relationships between the major departments of this company.

Mr. Morris: I will allow the witness to answer the question subject to the objection of counsel for the petitioner. You may proceed.

The Witness: What this table shows is the crude oil self-sufficiency ratio of Humble. This is a widely understood and known ratio. The higher the ratio, the more coveted, that is the more valuable it is to an oil company.

What this ratio shows is the high degree of ownership of oil in relationship to the refining capacity. From 64 percent to 70 percent of Humble's refining capacity is covered by its own crude oil production which gives us one of the higher ratios in the industry. It thus means that Humble is able to obtain an assurance of the supply of crude oil, that it obtains profits as well as loss in its crude oil operation, that this crude oil is very important in planning the expansion of the refining capacity, and that the refining capacity then is used to sell products directly or indirectly on an exchange basis into its own marketing operations so the crude oil self-sufficiency ratio is indicative of a strong vertically-integrated petroleum company.

Mr. Shapiro: Exhibit 36 is moved for admission into evidence.

Mr. Ragatz: I object. There has been no foundation laid for where these figures came from, nor has it been connected in any way to the tax issues in this case.

Mr. Morris: It will be received subject to the objection. You may proceed.

Q. Was the Humble marketing operation in Wisconsin during the years in issue in any way dependent upon Humble's E and P operation outside of Wisconsin?

Mr. Ragatz: Same objection; no foundation.

A. I think I already testified to the fact that Humble's Refining operation was dependent upon its crude oil production activities, and similarly, its marketing operation was dependent upon its refining activities, and the relationship thus also carries that the marketing operation is also dependent upon the E and P operation of an integrated petroleum company.

Q. In your opinion were the operations of Humble in Wisconsin dependent upon its operation outside this state?

Mr. Ragatz: Same objection; no foundation.

Mr. Morris: You may answer subject to the objection.

A. In my judgment the Humble operation within the State of Wisconsin was very much dependent upon its marketing, refining and crude oil operations outside the State of Wisconsin. In the case of marketing, Humble's Wisconsin operation benefited from the use of the same brand that was being used in many other states. It provided a continuity of a brand for the inner state traveler coming into the state, for people taking up residence within the state. This brand was extremely important to the Wisconsin operation.

Furthermore, the Humble marketing operation in Wisconsin was dependent upon the credit card that was used and interchangeable between operations within and without the State of Wisconsin.

Furthermore, the compatability or similarity of the architectural nature of Humble's stations within and without the State of Wisconsin presented a marketing contribution to the State of Wisconsin operation.

Q. Does Humble's Wisconsin operations contract to Humble's activities outside of Wisconsin?

Mr. Ragatz: Same objection; no foundation.

The Witness: Yes, in my judgment.

Mr. Morris: Just a moment. I think, Mr. Shapiro, he answered regarding the activities.

Mr. Shapiro: Yes. This is the last question. We have talked about contribution and dependence.

Mr. Morris: You may answer the question again subject to objection of counsel.

The Witness: Yes. The Humble Wisconsin operation contributes to Humble's operations without the State of Wisconsin. One of the things that the operation within the State contributes to the overall is the market share that Humble has developed and has during this period of time in the United States. The market penetration of Wisconsin is added to the market penetration of areas without and contributes to the production of a ratio which is presented in trade journals there over all market share in the United States.

Furthermore, the Wisconsin operation presents an outlet for its refined products that are sold on an exchange agreement which then is part of the assured sales for its refining operations. So it does similarly contribute to the operations out of the State of Wisconsin.

Mr. Shapiro: I have no further questions.

Mr. Morris: You may cross-examine, Mr. Ragatz.

Mr. Ragatz: Can we have a break at this point?

Mr. Morris: We will take a five-minute break.

(Recess taken at 3:17 p.m.)

Mr. Morris: Mr. Ragatz, you may proceed with your cross-examination.

Cross-Examination

By Mr. Ragatz:

Q. Mr. Allvine, how old are you?

A. Thirty-eight.

Q. And you are an Associate Professor?

A. That's correct, sir.

Q. And prior to going to Georgia Tech about a year ago you were an Assistant Professor at Northwestern?

A. That's correct.

Q. Have you held any other academic positions?

A. Yes. I was an instructor at the University of Kansas for one year.

Q. Instructor. What year did you get your Ph. D.?

A. I got my Ph. D. in 1966. It was a D. B. A. to be more precise.

Q. Doctor of Business Administration?

A That's right.

Q. Concentration in marketing?

A That's right.

Q. Now would you agree that in the academic world that the study of economics is a distinct and a different discipline than the study of business and recognized as such by the schools?

A. No, sir. I really don't. The education that the schools give have as their foundation economics as well as the basic disciplines that go into making up a business curriculum. It is one of the three fundamental legs of business curriculum in many schools today.

Q. Basic courses?

A. Basic and advanced courses in economics.

Q. Isn't it true that the Indiana University has a separate School of Economics distinct and different from its School of Business;

A. They teach economics both within the School of Business and without the School of Business. My economics training was in the Department of Economics and not in the Department of Business Administration at Indiana University.

Q. I see. But you did not take enough economics to get a Ph. D. in economics?

A. No, sir. I had a Minor in economics.

Q. All right. What specific background other than the documents in this case have you obtained relative to the operation of Humble's marketing activities in the State of Wisconsin during the years 1965 through 1968? And I want you to be specific.

A. Other than the information acquired from documents presented in this case; is that your question?

Q. That's correct.

A. No other information.

Q. You have no other information concerning Humble's marketing operations in the State of Wisconsin. Now other than the documents and testimony in this case what information do you have, specific information, do you have relative to the actual transfer prices used by Humble during the years 1965 through 1968 for transfer of its crude oil between its E and P function and its Refining function?

A. As I testified, the knowledge I have in that regard is related to the standard financial practice permitted by the Federal Income Tax Department and laws relative to depletion allowance which, for all companies, is based upon the posted field price of crude or which is published on a daily basis in the Platt's Oilgram price service that I have subscribed to and studied.

Q. But you don't have any specific information as to which posted field prices were used by Humble?

A. The only field prices which are allowed are those that are relevant to the particular pool of oil that is being pumped.

Q. Well, do you know which field prices those were that were used by Humble?

A. In some cases Humble posted the field price as presented in the Platt's Oilgram and others where they had lesser interest they took the prices that other people posted.

Q. Well, you have answered my question in general terms twice, but I have very carefully asked you specifically, can you testify as to specific posted field prices used by Humble during the years in issue?

A. If I were to take the Platt's Oilgram price services and proceed through that I could trace through for you, with the amount of time that might be needed, the posted field prices as Humble has established in certain areas.

Q. You said you could do that. Have you done that?

A. No, I have not taken and proceeded to develop the field of posted prices established by Humble throughout the United States.

Q. And you have no other information on what specific posted field prices Humble used during the years in issue for those internal transfers?

A. I have the sworn statement of your witness that said that Humble followed the standard procedures of all the other integrated oil companies in taking the posted field price.

Q. My question is other than the testimony in this case you have no information than that?

A. No, sir.

Q. Now do you have any specific information other than that presented in this case as to what transfer prices Humble used as to natural gas and its transfer from the E and P function to the Refining function?

A. No, sir.

Q. Do you have any information other than that presented in the testimony in this case as to the transfer prices used by Humble on the transfers of products from its Refining function to its Marketing function?

A. Only based upon the exchange agreemeent as documented in this particular case.

Q. And no other information?

A. No, that was all the gasoline that Humble attained the State of Wisconsin. That covers the entire supply.

Q. My question was outside of this case that you don't know as a fact whether that was all the gasoline that Humble obtained in the State of Wisconsin or not, do you?

A. That was based upon the testimony that that was the source of—

Q. I asked you, you don't know that of your own knowledge?

A. Only under sworn testimony that I heard in this courtroom.

Q. But outside of the testimony in this case I have said three times now, you have no personal knowledge of that yourself?

A. No, sir.

Q. Have you ever examined a Humble posted field price bulletin applicable to the years 1965 through 1968?

A. No, sir.

Q. Now outside of what you have learned in the testimony and exhibits in this case, have you ever personally made any kind of internal examination of the functional organization or operation of Humble and particularly as to the transfer prices on crude and natural gas from E and P to refining and on products from refining to marketing?

A. I sure would have liked to.

Q. But you haven't?

A. No, sir.

Mr. Ragatz: No further questions.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: No further questions.

Mr. Morris: You are excused. Do we need this witness for any further testimony?

Mr. Ragatz: Not me.

Mr. Morris: Therefore the witness is excused and will not be recalled unless stated.

(Witness excused)

Mr. Morris: Gentlemen, we are now through with this witness. Mr. Shapiro, you have another witness that's not available at this time, is that correct?

Mr. Ragatz: I would like to make a suggestion on that. I am very concerned. I want to accommodate Irv. He has been accommodating in this case and I don't want to push him. I think his witness, though, who got into town last night has had more time to examine transcripts than our expert witnesses.

Mr. Shapiro: The one transcript—

Mr. Ragatz: Dr. Solomon just got into town yesterday. He read yesterday's transcript last night and examined the other documents and he was prepared to testify this morning. Now I don't want to push Mr. Shapiro so I am going to suggest this as a compromise that we start this proceeding at 10:30 tomorrow morning with the hope that we can at least finish direct examination by noon. Then we would know as to all witnesses who we might have to retain for rebuttal and who we can let go home. And I think that would be compatible with our side of the case and I hope that would be compatible with the State's side.

Mr. Shapiro: Yes. I think we should make an effort to do that and we will do so.

Mr. Morris: All right. Gentlemen, at this time I have a request that we adjourn this hearing till tomorrow at 10:30, is that right?

Mr. Shapiro: Yes.

Mr. Morris: At this time we will take a five-minute break and and I will take it up with the Chairman of the Commission and will let you know that decision based on that.

Be back in five.

(Recess taken)

Mr. Morris: Let the record note a conference was held off the record regarding further testimony in this case, and based on the request of Mr. Shapiro and no objection by Mr. Ragatz, this matter is adjourned to 11:00 tomorrow, October 10, 1974.

Anything else to come before us today, gentlemen?

Mr. Shapiro: No, sir.

Mr. Ragatz: Nothing.

Mr. Morris: This matter is adjourned.

(Hearing adjourned 3:45 p.m.)

STATE OF WISCONSIN — WISCONSIN TAX APPEALS DIVISION

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),
Petitioner,

vs. Docket No. I-3806

WISCONSIN DEPARTMENT OF REVENUE,
Respondent.

CERTIFICATION

KAREN A. CHERRY
MINDLA COMINS
LORETTA PETERS,

hereby certify that as the duly appointed reporters, we took in shorthand the testimony and proceedings had in the foregoing matter on the 9th day of October, 1974, and that the attached is a true and correct transcription of said shorthand notes and of the whole thereof.

Dated this 9th day of October, 1974.

/s/ *Karen A. Cherry*
Karen A. Cherry
/s/ *Mindla Comins*
Mindla Comins
/s/ *Loretta Peters*
Loretta Peters

TRANSCRIPT OF PROCEEDINGS in the above-entitled matter held before the Wisconsin Tax Appeals Commission, in Room 229, City-County Building, Madison, Wisconsin, on the 10th day of October, 1974, commencing at 11:00 o'clock in the forenoon.

Mr. Morris: On the record, let the record note that this is a continued hearing, October 10, 1974, in regard to the above matter.

Mr. Shapiro, you may call your next witness.

Mr. Shapiro: The respondent will call Mr. Frank Keesling.

FRANK KEESLING, called as a witness, having been first duly sworn under oath, testified as follows:

Direct Examination

By Mr. Shapiro:

Q. What is your address, Mr. Keesling?

A. My home address is 2356 Holly Ridge Drive, Los Angeles, California, 90068.

Q. What is your present occupation?

A. I am an attorney.

Q. What is your educational background?

A. Well, I graduated from the University of California with an AB degree in 1928, and from the University of California Law School, commonly known as Boalt Hall in 1931.

Q. Have you published any papers or articles in professional journals?

A. Yes, I have; quite a number.

Q. Have you written any books?

A. Yes, I was the co-author of a book on allocation of income and state taxation with George Altman, the first edition was published in 1946 and the second edition in 1950.

Q. I show you this book. It will not be offered into the record, but is this the second edition?

A. This is the second edition, yes.

Q. Have you lectured and discussed allocation problems?

A. Yes, quite extensively. I was formerly a member of the National Tax Association, and I was a charter member of the Association of State Tax Administrators, and I often attended those meetings and I often addressed section meetings, I lectured to a group of bankers on allocation problems, and recently I addressed the Multi-State Tax Commission in Denver, on a very important allocation matter.

Q. What has been your principal area of research, writing and publishing?

A. Well, almost all of it has been confined to state tax problems, some local problems, a great deal of it is related to allocation problems.

Q. And for how long a period?

A. Well, it has been going on for a period of over 40 years. I think that the first writing I did was in 1933, and I helped write three articles on the California franchise tax. In 1935 I wrote an article on the California income tax, and I wrote a chapter in a book called *Ballantine's California Corporation Laws* which was devoted to the California franchise tax, and later I wrote an article on the residence problem in state taxation, and more recently

I have written articles dealing with local property taxes and also articles dealing with the unitary concept and allocation of income; and even more recently an article dealing with the Uniform Act; in fact, there were two different installments.

Q. Have you served with any government agencies?

A. Yes, I served with the State of California from 1931 to 1939, a period of eight years, four of those years I was with the State Board of Equalization in various capacities, and wound up as Assistant Secretary of the Board, and then I transferred to the Franchise Tax Commissioner's office, the predecessor to the present Franchise Tax Board, and I was there for approximately four years.

Q. Did you have extensive experience with problems relating to the unitary concept?

A. It was the Franchise Tax Board, there was a great deal of work in connection in the allocation field. When I went there, although the formula method was used to some extent, there was no definite policy, it was left up to each individual auditor. I introduced the practice of using the formula method in the case of unitary businesses, and I did my best to explain to the officers what a unitary business was so they would recognize one when they saw one.

One of the cases to which that policy was applied is a case noted Butler Brothers versus McOlgan, a company operated seven wholesale department stores in seven different states. All of the goods for all stores were purchased centrally in Chicago where the headquarters office of the company was located. The Attorney General's office wanted to stipulate judgment in favor of the taxpayer, but I insisted the business was unitary and the case be tried. This was agreed to on the condition that I would write the brief, which I did. It has become one of the leading cases in the field.

Q. Have your books or articles been referred to or cited as authority in any court decisions and opinions?

A. Yes, quite extensively cited and quoted in court decisions, administrative decisions, law review articles.

Q. Was your work cited in the case of Interstate Finance Company, 28 Wis. 2nd, 262?

A. Yes, it was.

Q. And I have a copy of Page 269 before you, and I will read this for the record:

> "The text authority Altman and Keesling in *Allocation of Income and State Taxation,* 2nd Edition, Page 101, states: 'The essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside of the state. If there is such a relationship, the business is unitary.' "

Did you devise that formula?

A. Yes, I did. May I explain a little bit there?

Q. Yes.

A. There are two classic definitions of unitary business.

Q. Well, I would like to reserve that for just a moment. Has this definition been widely accepted?

A. Yes, it has.

Q. Have you submitted recommendations on allocation problems to any committee of Congress?

A. Yes, I did.

Q. Have you testified as an expert in court?

A. Yes, I have.

Q. In what case?

A. Well, the first time was in the State of Colorado in a case against General Motors. The problem involved was a reasonableness of their particular allocation formula. I testified I thought it was a reasonable formula.

The second case was for Kennecott Copper Corporation in the State of Utah involved with franchise tax. The matter I testified on was whether the business was unitary, and I testified that it was unitary.

Q. Did you testify in the General Motors case as a witness for the State or the company?

A. As a witness for the State.

Q. For the State?

A. Yes.

Q. And in the Kennecott Copper Company did you testify as a witness—

A. As a witness for the taxpayer.

Q. For the taxpayer? Are you familiar with the facts of this case?

A. Well, I have been spending the last 48 hours reviewing the transcript. I think I am familiar with a great many of the facts, certainly.

Q. Have you examined other materials relating to the case?

A. Yes, I have.

Q. And these materials—were these materials submitted to you?

A. These were submitted to me.

Q. Mr. Keesling, what is the distinction between a unitary and nonunitary business?

A. Well—

Mr. Ragatz: Excuse me; if I might, at this point, I am not sure what this witness' background is in economics, and before this witness should be allowed to answer that kind of a question, I think we should determine whether he is qualified as an economist to give an economist's type of opinion. If I might ask a couple of voir dire questions I could determine that as to whether there is a ground for objection on his qualifications as—

Mr. Shapiro: I submit it is quite apparent that Mr. Keesling is not testifying as an economist, but as a tax expert.

Mr. Ragatz: I think the question you asked, if I understood it correctly, called for an economist's conclusion. It

isn't the application of the tax law, it is involving economic concepts that only an economist could give an opinion on.

Mr. Shapiro: If it isn't implied, it could certainly be expressed that the question, "What is the distinction between a unitary and a nonunitary business," we could—the three words could be added, "for tax purposes."

Mr. Ragatz: It is still an economist's concept.

Mr. Morris: Gentlemen, again a question of Mr. Shapiro on the testimony of this witness, your witness, he is basing his answers on his past performance as what? A lawyer? Economist? Or what?

Mr. Shapiro: As a specialist in the area of allocation of state income, allocation of income for state tax purposes.

Mr. Morris: I will allow him to answer the question subject to the objection of counsel.

Mr. Ragatz: I would like the record to note my objection that there has been no foundation laid that this man has had any training in economics or any experience as an economist.

Mr. Morris: I will allow him to answer the question subject to the objection. Counsel for the respondent, you may proceed.

By Mr. Shapiro:

Q. Mr. Keesling, what is the distinction between a unitary and a nonunitary business?

A. Well, I think the distinction is implied in the definition I devised years ago; the dependency and contribution definition. Previous to that there was another definition commonly known as the three-unities definition, unity of ownership, unity of use, and unity of operation. That came to light in the Butler Brothers case.

I was never very well satisfied with it and when I wrote on this subject with Mr. Altman I did my best to contrive a better definition, one that would be more understandable and be easier to apply and draw a dividing line between unitary and nonunitary businesses and I came up with the

definition that if a portion of the business is in the state, either dependent upon or contributory to the portion outside of the state, the business is unitary, and I gave examples of unitary businesses and examples of nonunitary businesses.

Q. Did you finish?

A. Yes.

Q. Now, based upon your extensive background as a specialist in the matter of allocation of income in state taxation and your review of the record in this case to date, is it your opinion that Humble's marketing operation in Wisconsin in the years in issue was a part of a unitary business?

Mr. Ragatz: Objection. There has been no foundation whatsoever that this witness knows anything other than what has been presented in this record about Humble.

Certainly he can't be permitted to testify as to that question without a proper foundation that he has some personal experience so he has a basis for knowledge. The witness yesterday made some individual studies. There hasn't been one word of that, that this witness knows anything other than what has been presented in the record so I strenuously object to the witness being allowed to answer that question unless a proper foundation is laid.

Mr. Morris: Mr. Shapiro, I would have to sustain the objection of counsel for petitioner in that I have no knowledge of what records this witness has read regarding this case or the background of this case, so I would suggest if you wish to continue that you lay some type of foundation regarding what knowledge this witness has regarding this case as an expert.

By Mr. Shapiro:

Q. Mr. Keesling, what factors in this case on the basis of your review thereof would you consider in determining whether Humble was a unitary business during the years in issue?

Mr. Ragatz: Just a minute, please. Let me ask if he is asking on the basis of this record, and if this witness is allowed to answer, then anybody in the courtroom or in the City could give an opinion on the same subject if they examined the testimony and exhibits in this case.

Mr. Shapiro: But I submit that anybody is not an expert, and we have an expert in the field.

Mr. Morris: Mr. Keesling, what have you reviewed in this record?

The Witness: Pardon?

Mr. Morris: What have you reviewed in this record?

The Witness: Well, I have gone through, I think, five different transcripts in connection with the opening days.

Mr. Morris: What transcripts have you gone through?

Mr. Shapiro: He said five.

Mr. Morris: I don't know which ones. I am trying to determine what he has read in the record. You weren't present during any of the testimony in this case?

The Witness: No, I was not present, but I read the transcripts.

Mr. Morris: Which transcripts have you read?

The Witness: Well, I have read all but one. I know I read the ones that brought out a lot of factual information about this company.

Mr. Morris: I won't disagree, but the question we are trying to determine is what part of the record you have read and what exhibits you have examined.

The Witness: Well, would someone hand me the transcripts? I can identify the ones I read.

Mr. Morris: I would like the record to show what you have read, what exhibits you have reviewed.

The court reporter will note that Mr. Shapiro is now reviewing certain transcripts regarding this matter.

The Witness: Well, I read the transcript of the testimony on the 2nd day of October; that's number one.

Mr. Morris: Of what witness?

The Witness: Well, I think the primary witness was the auditor that made the assessment.

Mr. Morris: You think; do you know?

The Witness: Well, they started out—it was opening statements by both Mr. Shapiro and Mr. Ragatz, and then the witness was called and he was questioned at length by Mr. Ragatz as to what was in his report and the basis upon which he made the conclusions that the business was unitary, but I am not positive of his name.

Mr. Morris: Mr. Ragatz, can you help him?

The Witness: Mr. Sheridan.

Mr. Morris: You read the transcript of the record of the examination in this hearing of Mr. Sheridan, is that correct?

The Witness: Yes, I read that.

Mr. Morris: The entire transcript you read?

The Witness: I read the entire transcript.

Mr. Morris: You may proceed. Any others?

The Witness: Yes, I read substantial parts of all of the other four transcripts here.

Mr. Morris: That would be of whom?

The Witness: Now, in the second one they called a Mr. Kaspar who I understand had been with the Department and there was a follow-up of Mr. Sheridan's testimony, I think. Most of it is Mr. Kaspar's.

Then I read in the next transcript the testimony of a Mr. Luper.

Mr. Morris: Did you read the entire transcript?

The Witness: No, I did not read the entire transcript.

Mr. Morris: What portion of the transcript of Mr. Luper's did you read?

The Witness: Well, I read all of his. I think this is quite extensive.

Mr. Morris: You read the entire transcript of Mr. Luper?

The Witness: Yes.

Mr. Morris: Any others?

The Witness: Yes, I read the transcript on the 7th day of October, and I recall one of the witnesses testifying about his connection with the company, how many jobs he had held, and the number of transfers of the personnel from one job to another, and the amount of experience he had had in the oil business.

Mr. Morris: Do you remember whose transcript that was?

The Witness: Well, Commissioner, my memory isn't as good as it used to be and when it comes to remembering all these names I am not able to do it.

Mr. Shapiro: May I refresh his memory?

Mr. Morris: Yes, you may.

The Witness: Yes, it started with—

Mr. Shapiro: Is Mr. Campbell the other gentleman you refer to?

The Witness: I believe they come later.

Mr. Morris: We will give the witness time to review the transcripts.

Mr. Morris: Mr. Shapiro, can you refresh the witness' memory with Mr. Campbell, was it?

Mr. Shapiro: Yes. Was it Mr. Campbell that you were referring to?

The Witness: I will have to find it here in the transcript to be sure of the name.

Yes, here is a Mr. Campbell.

Mr. Morris: Any others?

The Witness: I don't think so.

Mr. Morris: There were just the four transcripts then?

The Witness: Yeah. I read the transcript, I read parts of the transcript covering yesterday's—of the accountant, economist and his explanations of what he considered to be the testimony of a unitary business and his opinions.

Mr. Morris: And that would be whom?

The Witness: Pardon?

Mr. Morris: Who would that be; Whose transcript is that?

Mr. Shapiro: I believe that's indicated right here, sir.

The Witness: Mr. Koonce.

Mr. Shapiro: No. I believe this is it right here.

The Witness: Mr. Solomon, yes.

Mr. Morris: Mr. Solomon?

The Witness: Mr. Solomon.

Mr. Morris: Besides the transcripts which you have just put into the record as reading, what exhibits have you read or reviewed in this matter?

The Witness: I have only read two. Those were copies of two Wisconsin cases in this field.

Mr. Morris: Do you remember what exhibits they were?

The Witness: They were copies of two cases.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: I suggest they probably were not exhibits in this case, the two tax cases Mr. Keesling is referring to.

Mr. Morris: Then did you review any of the exhibits in this matter?

The Witness: I have not reviewed anything that anyone has said that these were the facts in this case, the subsequent material in the transcripts.

Mr. Morris: So your testimony to this Commission today is you have not seen or reviewed any of the exhibits that have been received in evidence in this matter?

The Witness: No, I have not.

Mr. Ragatz: Might I inquire whether he has examined the testimony of Mr. Wehner or Mr. Koonce as it pertains to the subject he is attempting to testify to?

Mr. Morris: Mr. Keesling, have you examined the testimony of Mr. Wehner or Mr. Koonce in this case?

The Witness: What was the first name?

Mr. Shapiro: Wehner, W-e-h-n-e-r.

The Witness: I don't recognize the name.

Mr. Morris: Or Mr. Koonce?

The Witness: Well, just let me see here.

Mr. Morris: All right. We will take a five-minute recess pending the review of those documents for further testimony.

(Recess—11:30 a.m.)

Mr. Morris: Mr. Shapiro, you may proceed.

The Witness: I read some of Mr. Koonce's testimony. I remember reading that he was in the Tax Department and he reported to the tax manager and that he testified about posted field prices and to the best of his opinion as to what income was realized.

I didn't pursue it very far because I am of the opinion that in the case of a unitary business the prices at which goods transfer from one division to another is irrelevant. In the unitary business you look at the whole operation and the incoming transfers are dropped out. So I didn't pursue that much farther.

Mr. Shapiro: Mr. Commissioner, do you wish to rule on any objection?

Mr. Ragatz: Has he answered the question to whether he read the testimony of Mr. Wehner?

Mr. Morris: Did you read the testimony of Mr. Wehner?

The Witness: Pardon?

Mr. Morris: Did you read Mr. Wehner's testimony?

The Witness: No, I did not.

Mr. Morris: He did not read Mr. Wehner's testimony.

You may proceed, Mr. Shapiro, and ask your questions. And regarding this matter I would assume that he is a qualified expert and he would testify on only matters that he has read or has personal knowledge of in this case. But I will leave it up to you which questions you want to ask and where you want to go on that.

Mr. Shapiro: Well, we did submit one question to him with regard to Humble that was objected to. And do you wish to rule on that?

Mr. Morris: Well, I will have the question read back here. If you wish to ask the question again, you may proceed.

Mr. Shapiro: I will, I will.

Mr. Morris: You may proceed.

By Mr. Shapiro:

Q. Based upon your extensive background as a specialist in the allocation of income in state taxation and your review of the record in this case to date, is it your opinion that Humble's Marketing operation in Wisconsin during the years in issue was a part of a unitary business?

Mr. Ragatz: Same objection. There has been no background foundation laid that this witness knows anything about Humble's operations in Wisconsin other than what he may have read from the portions of the record he has read. And I submit that that's not sufficient background to allow him to express an expert opinion.

Mr. Morris: Mr. Shapiro, just a question of you. The question you asked of Mr. Keesling who has not reviewed any exhibits in this matter and has indicated by his testimony that he has only read the testimony in the record of certain witnesses on which he can base his opinion—now the question you asked is only on that portion which he has read or only that which he is familiar with and no other?

Mr. Shapiro: I will instruct him to do so.

Mr. Morris: I will allow him to answer the question subject to objection of counsel for the petitioner.

By Mr. Shapiro:

Q. Mr. Keesling, based upon what your review has been to date, would you please answer the question?

A. Yes. I have read a substantial part of these transcripts and there are some facts that I think are quite significant in determining this question. Now it is my understanding that Humble Oil, first of all, relates to the years 1965 and 1968 and that during those years Humble had extensive Marketing operations in the State of Wisconsin. I believe my memory is correct that products were sold to service stations here; they sold gasoline, fuel oil, heating oil, motor oil, tires, batteries and various types of things commonly sold at service stations.

It is my further understanding that these products were not produced in the State of Wisconsin, were all acquired outside of Wisconsin. I understand that the gasoline, the heating oil and the fuel oil were acquired in an exchange, that the company purchased crude oil and exchanged the crude oil with other independent companies with those three products which I mentioned.

I understand that these were the major items sold in Wisconsin and that the other items were all in part and were relatively smaller. Some of the other products were manufactured or produced by the company iteslf. And I understand that it does not apply to the tires or batteries or items of that character.

Now here we have a situation where a company is doing business in the State, is doing business out of the State, and everything that's sold in the State is acquired by it out of the State. In other words, we have two different functions being performed, one, the acquisition of the products and the other the sale of the products. And those take place in different tax jurisdictions. That's the hallmark of a unitary business.

The State of Wisconsin operations are completely dependent for its products upon the operations of the company in other states. That's one part.

Number two, the operations in Wisconsin contribute substantial sales and that's the contribution to the overall business. There are other important items of unity. I believe that Mr. Luper testified that he himself had occupied, for a period of a great many years, a number of different positions with Humble; and he was asked the question whether that was common and he replied it happened frequently. In other words, there are exchanges of personnel within the different divisions of Humble.

Now that, I think, is a significant factor in a company like Humble that are not compelled, when they need new personnel to replace someone or for a new additional job, they are not compelled always to go outside and get someone who may not be fully qualified, who may not be the type of person to fit into the organization. They already have people that they can select and whom they know and who has had experience with the company.

I understand that there is a headquarters office in Houston, that there was some 2,500 to 3,000 people stationed there, that the President's office is there and the Tax Manager's office is there, that the company follows the practice of purchasing substantial quantities of materials and supplies centrally.

I know from my experience in business matters over a period of 40 years that when you purchase property centrally in large quantities you can get quite a number of benefits. And one thing you may get discounts in the purchase price. Secondly, you may get much better service than you would if you are operating on a small scale or if each little branch in each state did its own purchasing.

I understand that the company is sufficiently large that it is not required to carry, does not follow the practice of insurance, but carries its own insurance. That must result in enormous savings to the company because insurance is certainly a very extensive item.

Now I understand, also, in one of these transcripts that there is a certain amount of centralized advertising, but I am not sure the extent of it. There is not a great deal—I didn't come across a great deal of information about pension plans, but again I think it was Mr. Luper who testified that he was a member of the pension plan of the company. And I assume from that that the company does have a pension plan. That, again, I think is an indication of unity.

I think, also, the use of a common name, Humble, in the business in a number of different states is an element of unity. It has been my experience, my own personal experience as well as experience of members of my family and friends, that people often get associated with one company and then they continue, wherever they happen to go, they will patronize that particular company. Maybe it is Standard Oil products or maybe it is Gulf products, but they will do that. And I am sure with the name Humble, well known as it is, I have heard of it many times long before I heard of this case, that it's an honorable name. And I am certain that there must be people that have helped the company's business.

Mr. Morris: Mr. Shapiro, do you have any other questions?

The Witness: Now those are the main facts that I have been able to elicit out of the testimony that I read.

Mr. Shapiro: May I repeat the question for his benefit?

Mr. Morris: Yes.

By Mr. Shapiro:

Q. Is it your opinion, Mr. Keesling, that Humble's Marketing operation in Wisconsin during the years in issue was a part of a unitary business?

A. Yes, it is, unquestionably.

Mr. Morris: Based only on that testimony which he has read to date, is that correct?

Mr. Shapiro: Yes.

Mr. Morris: And no exhibits in this matter?

Mr. Shapiro: Okay.

By Mr. Shapiro:

Q. Mr. Keesling, I show you a transcript of the 9th day of October, 1974, and this refers in general to—I read from the testimony of Ezra Solomon; and I would like to read a question and an answer on Page 8 and will you follow it, please.

By Mr. Shapiro:

Q. "Q. Now I would first like you to talk about three terms: unitary, integrated and integral parts; and perhaps, first, you could explain these terms in the common layman's sense in which they are sometimes used and then explain them as an expert economist, if you would.

"A. Well, like so many terms in the applied social sciences, these three terms that you name don't have an objective, unambiguous meaning. They have to have a meaning within a context in which they are used.

"For example, in the purely layman or literal sense of the word, unitary applies to anything from the atom to the whole universe in fact. The universe has the word 'uni' in it, too. In other words, it is thoroughly meaningless because it could apply to anything.

"And the same thing could be true of the word integrated which means to bring together. Used in a business context, all businesses, small and large, from the family restaurant onward integrate or bring together several different processes or operations. So there, too, it has no particular meaning. Everything is integrated; everything is unitary.

"One has to move from that kind of literal dictionary meaning to a more functional economic meaning. And there I think the essence of a unitary operation refers to that collection of activities which can feasibly

be conducted as an economic unit in the marketplace. It may itself consist of many little steps, but they have to be performed collectively to provide economic viability. Such a company would be a unitary company, meaning each operation is essential to its viability in making a profit at all and you cannot do without any of them."

As an expert in the field of allocation of income, do you agree that Professor Solomon's statement is an acceptable definition for the purpose of allocation of income as between states?

Mr. Ragatz: Objection. Clearly that was the testimony of an expert economist, and the rules of evidence simply don't permit a layman to give opinions on the testimony of experts. This gentleman can testify as to facts, but he has not been shown to be qualified as an economist, and certainly cannot comment upon or give opinions upon the testimony of our expert economist witness.

Mr. Shapiro: But I submit he may give his opinion as regards the issue, a tax issue in this matter.

Mr. Ragatz: I would like to point out that if that is counsel's objective, he has read the wrong part of the transcript because that was not the definition that Professor Solomon gave of the terms for tax purposes.

Mr. Shapiro: We have others.

Mr. Morris: Mr. Shapiro, I will allow this witness to answer in his opinion, and again not comment on someone else's opinion. You qualify him as your expert witness, and he may testify if he is qualified as your expert witness, on his opinions, but as to someone else's opinion, another expert's opinion, I think Mr. Ragatz' objection would be sustained.

If he has an opinion, he may state his own opinion.

By Mr. Shapiro:

Q. You may state your opinion, sir.

Mr. Ragatz: Again, I interpose that now he is clearly asking for an economist's opinion and this man is not an economist.

The Witness: I would like to make my statement very brief. The point I will address myself to is the statement that the relationship between different activities must be essential in order for the business to be unitary. That is not the test.

The test is contribution or dependency. If the operations contribute toward a common income, the operations are unitary whether they are essential or not.

Mr. Shapiro: I will read as follows on Page 9—

Mr. Ragatz: I would like to point out for the record that the witness has just responded, as I understand it, to give an opinion on Dr. Solomon's testimony, which is precisely what the Chair said he should not do.

Mr. Morris: The Chair will rule that he gave an opinion based on the set of facts he knows, is that correct? Your opinion was based upon your own knowledge and your own facts?

The Witness: Based on my own knowledge.

Mr. Morris: And not on what Mr. Solomon's opinion was.

The Witness: I have spent a substantial portion of my life dealing with these problems; I have sat in on numerous, numerous conferences when I was with the State and I represented many taxpayers, and I have listened and I formed judgments and opinions and conclusions as to when business is a unitary business and when they are separate.

Mr. Morris: Mr. Shapiro, you may proceed.

Mr. Ragatz: If counsel now proposes to read more of Professor Solomon's testimony to elicit opinions, then we are still going down the road where this witness is not

qualified to respond, and I interpose my objection at this time to any more reading of Dr. Solomon's testimony for this witness to comment on.

Mr. Morris: Mr. Shapiro?

Mr. Shapiro: I submit that the witness is asked to respond with his views to Professor Solomon's statements bearing on the tax matters at issue, and his evaluation is asked for and that is all. That may be weighed by the Commission.

Mr. Morris: I agree with you, it may be weighed by the Commission, but again Mr. Solomon has testified, and what I would suggest you do is ask him a question and ask him his opinion.

Mr. Shapiro: Very well.

By Mr. Shapiro:

Q. Mr. Keesling, are the terms "integrated" and "unitary" synonymous?

A. No, they are not. The term "integrated" is a term that has often been used in connection with tax matters. I first heard of it in connection with gross receipts taxes, and an integrated business for that purpose is a business that has several different steps in the production of a product, possibly starting with the actual extraction of ore from the ground, the smelting of it, the making of it into various types of products, and the sale of the products, the wholesale and retail. That would be a completely integrated business.

In the field of allocation, particularly in connection with oil companies, we have a term with much the same meaning, an integrated oil company is a company that extracts the oil—first of all, exploration—it extracts the oil, it refines the oil and then sells it throughout the country, and a non-integrated oil company is commonly one which does the exploration and the extraction but sells the oil at the well head and doesn't do the refining and doesn't operate service stations and have other retail outlets of that kind.

Now in my opinion if you call a business integrated, it is necessarily unitary, but not all unitary businesses are integrated. Even a nonintegrated oil company could be unitary, depending on the extent of the centralized performance of functions and the amount of degree of management, the financing and all of the other things involved in oil production.

Q. Mr. Keesling, you have responded affirmatively to the question as to whether Humble's Marketing operation in Wisconsin was a part of a unitary business. I now ask you whether you know whether Humble's Marketing operation was an integral part of a unitary business?

A. Yes, it was.

Mr. Ragatz: I object. This calls for an economist's conclusion, and further there is no basis that this witness has knowledge or knows anything about their business and there has not been one word of testimony that this witness has ever had contact directly with the oil industry and Humble itself.

I don't know how the witness can be possibly qualified to give that kind of an opinion.

Mr. Morris: What does he base his answer on?

Mr. Shapiro: He bases his answer on his own knowledge and his review of the record to date.

Mr. Morris: On what record? The same—

Mr. Shapiro: The same.

Mr. Morris: He has not reviewed any of the exhibits.

Mr. Shapiro: Well, we are limiting it to the same matters.

Mr. Morris: I will allow him to answer the question based on the knowledge that he has received in reading the record as answered in the prior questions.

You may answer the question subject to the objection of counsel for petitioner.

The Witness: Yes, I think it is. It is an important part of the business. Without sales you don't have any income, and this provides sales, and I think it should be credited an apportionment part of the income derived by the company.

Mr. Morris: Mr. Ragatz, you may cross-examine at this time.

Mr. Ragatz: Can we have five minutes?

Mr. Morris: A five-minute recess.

(Recess)

Mr. Morris: On the record. Mr. Ragatz, you may proceed with your cross-examination.

Cross-Examination

By Mr. Ragatz:

Q. Mr. Keesling, you testified as to the essential test to determine whether or not a business was unitary, and you said quoting from the Interstate Finance Corporation case that the essential test was whether the business within the State is dependent upon or contributory to the operation of the business outside the State.

A. Yes.

Q. Are these two tests or are they one?

A. Either one; either one. If it is dependent upon or if it is contributory upon, they are in the alternative.

Q. They are in the alternative?

A. That's right.

Q. Have you ever criticized that definition?

A. Pardon?

Q. Have you ever criticized that definition?

A. Have I what?

Q. Have you ever criticized that definition?

A. Yes, I think like all definitions different people can have differences of opinions as to how this applies.

Q. You have criticized it yourself, haven't you?

A. I think; however, it is better than the three unities definition in that I think it at least gives a clue to what you are looking at.

Q. You disagree with the three unities definition in the Butler Brothers case?

A. Well, I wrote the brief in that case, and the definition was in my brief, but I never thought very much of it. However, the California Supreme Court liked it very much, and it spread all over the country.

Q. But you disagree with it; yes or no.

A. It is not a question of disagreeing. I don't know if it is very helpful. I don't disagree with it.

Q. Let's go back to the definition in the Interstate case. Is it your testimony that mere contribution is enough to make a business unitary?

A. Yes, it is.

Q. Didn't you say in the 1960 law review article in *Hastings Journal* that the company had to be both dependent upon and contributory to be unitary?

A. The California Supreme Court reversed me on that.

Q. But that was your opinion when you offered that?

A. Since then a lot of water has gone under the dam. I wrote that before the Superior Oil Company was decided in that case.

Q. I believe this answer is not responsive and I would like the Commissioner—

Mr. Morris: Mr. Keesling, your attorney has the right on redirect to clarify any problems. If you can respond to Mr. Ragatz' question, please do so.

The Witness: Will you repeat your question?

Mr. Ragatz: I think you answered my question. I am going on.

By Mr. Ragatz:

Q. Have you had any specific contact with the operations of Humble Oil and Refining Company and particularly these operations in the State of Wisconsin other than your review of the portions of the transcript in this case?

A. No, I have not.

Q. Do you know the brand name under which Humble sold gasoline in the State of Wisconsin during the years 1965 through 1968?

A. I think I read it in one of these transcripts, but I don't remember it.

Q. You don't know?

A. I don't remember it.

Mr. Ragatz: No further questions.

Mr. Shapiro: No further questions.

Mr. Morris: You are excused, Mr. Keesling.

Will we need him for further testimony in the future?

Mr. Shapiro: No, sir.

Mr. Morris: Mr. Ragatz?

Mr. Ragatz: Not for us.

Mr. Morris: Mr. Keesling, you are excused and you will no longer be called as a witness.

(Witness excused)

Mr. Morris: Mr. Shapiro, do you have any other testimony or documentation that you wish to introduce at this time?

Mr. Shapiro: No, sir.

Mr. Morris: Do you rest your case?

Mr. Shapiro: Yes.

Mr. Morris: Mr. Ragatz, do you have any further testimony or documentation that you wish to put on?

Mr. Ragatz: No. Mr. Commissioner, we would forego any testimony on rebuttal. I do have one housekeeping motion to make before the case closes and that is that I would like to be sure that I have moved to admit all the exhibits that we offered, and I think that has been done, and I would also like to make the housekeeping motion to move to conform the pleadings to the proof should in any sense that be necessary.

Mr. Morris: I have two motions before me at this time.

Do you have any objection to either motion?

Mr. Shapiro: No, I do not.

Mr. Morris: Hearing no objection, the motions made by Mr. Ragatz, counsel for the petitioner, the motions are hereby granted.

Mr. Ragatz, do you have any other motions to make or any further testimony or exhibits to introduce?

Mr. Ragatz: No, nothing further.

Mr. Morris: Do you rest your case?

Mr. Ragatz: We rest our rebuttal.

Mr. Morris: Any reason why the testimony in this case should not be closed?

Mr. Shapiro: No, sir.

Mr. Ragatz: No, sir.

Mr. Morris: Therefore, the testimony, the exhibits and all the matters relating are hereby closed.

Off the record.

(Discussion off the record)

Mr. Morris: On the record. The record will show that the testimony is hereby closed and that counsel for the petitioner has 60 days from today's date in which to file his brief, an original with the Commission and three copies thereto, and a copy to counsel for the respondent.

Counsel for the respondent has 60 days from the date of receipt of the brief from counsel of petitioners in which to file his brief and three copies for the Commission and return a copy to counsel for the petitioner, and, gentlemen, if necessary, counsels have 30 days alternately in which to file reply briefs through the manner as prescribed by the Commission's practice in the past. If additional time is needed by either counsel, I would request that a written request be made to the Commission and a copy of the correspondence be sent to the opposing counsel.

Further, that in your main briefs, that a portion be allocated to the proposed findings of fact and conclusions of law.

Any other requests?

Mr. Ragatz: You might indicate, if it is your desire, that both sides would have until November 15th to agree to any modifications of the transcript.

Mr. Morris: Any objection?

Mr. Shapiro: No, sir.

Mr. Morris: The request is granted. Mr. Ragatz, anything further to come before the Commission today?

Mr. Ragatz: Not for the petitioner.

Mr. Morris: This matter is closed.

Gentlemen, upon receipt of all necessary briefs, you will receive a written decision of this Commission. The matter is closed.

(Proceedings adjourned, 12:30 p.m.)

STATE OF WISCONSIN WISCONSIN TAX APPEALS COMMISSION

EXXON CORPORATION, (f/k/a Humble Oil and Refining Company),
Petitioner,
vs. Docket No. I-3806

WISCONSIN DEPARTMENT OF REVENUE,
Respondent.

CERTIFICATION

KAREN A. CHERRY
MINDLA COMINS
LORETTA PETERS,

hereby certify that as the duly appointed reporters, we took in shorthand the testimony and proceedings had in the foregoing matter on the 10th day of October, 1974, and that the attached is a true and correct transcription of said shorthand notes and of the whole thereof.

Dated this *10th* day of October, 1974.

/s/ *Karen A. Cherry*
Karen A. Cherry
/s/ *Mindla Comins*
Mindla Comins
/s/ *Loretta Peters*
Loretta Peters

Supreme Court, U. S.
FILED
JAN 9 1980
MICHAEL RODAK, JR., CLERK

APPENDIX (VOL. II)

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-509

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

UNITED STATES LAW PRINTING CO., CHICAGO, ILLINOIS 60618 (312) 525-6581

Jurisdictional Statement Filed September 26, 1979

Probable Jurisdiction Noted November 26, 1979

Volume II—Pages A. 601 to A. 799

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In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-509

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

APPENDIX (VOL. II)

A. 601

EXHIBIT 1

State of Wisconsin \ DEPARTMENT OF REVENUE

INCOME, SALES AND EXCISE TAX DIVISION
CORPORATION TAXATION SECTION
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

June 25, 1971

Re: 99-40723

Humble Oil and Refining Company
800 Bell Avenue
Houston, Texas 77002

RECEIVED
JUN 28 1971
HEADQUARTERS
TAX DEPARTMENT

Gentlemen:

NOTICE OF ASSESSMENT OF ADDITIONAL INCOME AND FRANCHISE TAXES

We are enclosing a copy of the report of our auditor, Mr. T. J. Sheridan, who was assigned by this office to make an audit and investigation of your books and records for the calendar years 1965 to 1968, inclusive.

The assessments for the years 1965 and 1966 are made pursuant to an agreement dated November 20, 1970 wherein the period of time for making such assessments was extended to June 30, 1971.

Exhibit A-B of the report indicates that you are subject to tax on or measured by additional income of $4,532,155.00. The additional taxes thereon, exclusive of interest which is to be computed thereon and added thereto in accordance with Section 71.09 (5)(a) of the Statutes, are as follows:

Total Additional Taxes $316,470.85

You are hereby notified of the above assessment of additional taxes pursuant to Chapter 71 of the Statutes.

If you feel aggrieved by this assessment notice you may make application to the Wisconsin Department of Revenue for abatement of the taxes, stating definitely and in detail each particular item in the audit report to which you object, together with the reasons for your objections. Such application must be filed in duplicate with the Department of Revenue within thirty days from the receipt of this notice. Wisconsin Statutes do not provide for an extension of this thirty day period.

If no application for abatement is made within the time specified above, this assessment will become final and conclusive and the additional taxes together with interest thereon will be certified for collection.

By C. J. Hoel
C. J. Hoel, Section Chief

RJM:kff
Enclosure
CERTIFIED MAIL
Return Receipt Requested

HUMBLE OIL AND REFINING COMPANY
800 BELL AVENUE
HOUSTON, TEXAS 77002

FRANCHISE TAX AUDIT REPORT

BY

WISCONSIN DEPARTMENT OF REVENUE

FOR THE CALENDAR YEARS

1965 TO 1968, INCLUSIVE

T. J. SHERIDAN
AUDITOR
MAY 1, 1971
KFF

HUMBLE OIL AND REFINING COMPANY

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HUMBLE OIL AND REFINING COMPANY

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Eau Claire, Wisconsin
May 1, 1971

Wisconsin Department of Revenue
Corporation Taxation Section
P. O. Box 98
Madison, Wisconsin 53701

Gentlemen:

In accordance with your instructions, an examination has been made of the books and records of Humble Oil and Refining Company, Houston, Texas, for the calendar years 1965 to 1968, inclusive and the report is submitted herewith.

Humble Oil and Refining Company was organized under the laws of Delaware in 1959 and is an integrated oil company, engaged in exploration, production, refining and marketing of petroleum and gas products. Humble Oil and Refining Company is a wholly-owned subsidiary of Standard Oil Company of New Jersey and is the domestic integrated oil and gas operation of the parent company.

The additional tax results from a change of method of reporting income to Wisconsin. Since Humble Oil and Refining Company is a unitary company and its Wisconsin business is an integral part thereof, formula apportionment of the company's income is mandatory and separate accounting is not permissable.

A review of the company's withholding and sales and use tax records and procedures for the calendar years 1965 to 1968, indicates that no adjustments are necessary at this time.

The adjustments included in this report have been discussed with Messrs. Behringer and Koonce of the company's tax department.

This opportunity is taken to express my appreciation for the courtesies and cooperation received during the course of the examination.

Respectfully submitted,

T. J. Sheridan
Auditor

Humble Oil & Refining Company

Computation of Additional Taxes

Exhibit A-2 1

Income Year	Reference	1965	1966	1967	1968	Total
Adjusted Net Income	Exhibit C	759,371.00	1,043,395.00	1,264,946.00	1,464,443.00	
Net Income Previously Computed		0	0	0	0	
Additional Net Income		759,371.00	1,043,395.00	1,264,946.00	1,464,443.00	4,532,155.00
Adjusted Franchise Tax		52,960.97	72,842.65	88,351.22	102,316.01	
Amount Previously Paid		0	0	0	0	
Additional Franchise Tax		52,960.97	72,842.65	88,351.22	102,116.01	316,470.85
Interest						
Total						

The above schedule of additional tax is exclusive of interest which is to be computed thereon and added thereto on overassessments and on underassessments as provided in Section 71.09(5)(a) and (b) of the Statutes. The Wisconsin Department of Revenue has no discretion in the matter of adding interest.

A. 606

Humble Oil & Refining Company

Reconciliation of Federal Taxable Income with Adjusted Net Income

Exhibit C 2

	Calendar Year	Reference	1965	1966	1967	1968
	Federal Taxable Income Before Special Deductions	Exhibit C-1	212,218,232.	286,576,163.	368,959,232.	409,574,769.
1	Reverse: Contributions Deducted		5,302,824.	5,578,075.	2,867,844.	12,266,167.
2	Municipal Interest Deducted		131,721.	418,920.	600,047.	50,972.
3	Percentage Depletion Deducted		210,200,000.	233,200,000.	265,400,000.	285,000,000.
4	Depreciation Deducted		225,844,863.	220,968,298.	212,855,980.	237,067,585.
5	Allowable Depreciation		(236,093,683.)	(229,565,919.)	(241,359,720.)	(259,581,653.)
6	Allowable Cost Depletion		(9,129,210.)	(15,994,699.)	(13,863,282.)	(16,793,795.)
7	Bad Debts	Schedule 1	3,667,080.	405,729.	4,764,430.	4,641,869.
8	Carved-Out Production - Proceeds		(49,877,000.)	(41,124,000.)	(38,710,000.)	(23,046,000.)
9	- Repayment		51,634,169.	56,402,121.	43,843,757.	40,015,573.
	Subtotal		413,898,996.	516,864,726.	605,358,288.	689,195,487.
10	Federal Income Taxes Deductible		(6,817,243.)	(42,638,820.)	(60,535,829.)	(68,919,549.)
11	Contributions Deductible		(3,487,101.)	(5,578,075.)	(2,867,844.)	(12,266,167.)
	Adjusted Net Income Before Apportionment		403,594,652.	468,647,833.	541,954,615.	608,009,771.
	Total Company Non-Apportionable Income	Exhibit E-4	192,350,946.	221,341,235.	280,027,892.	295,666,628.
	Apportionable Income		211,243,706.	247,306,598.	261,926,723.	312,343,143.
	Percent to Wisconsin	Exhibit E	.4071	.4483	.4932	.4550
	Amount to Wisconsin		859,973.	1,108,675.	1,291,823.	1,421,161.
	Wisconsin Non-Apportionable Income	Exhibit E-4	(100,602.)	(65,280.)	(26,877.)	43,282.
	Adjusted Net Income		759,371.	1,043,395.	1,264,946.	1,464,443.

A. 607

HUMBLE OIL AND REFINING COMPANY
800 BELL AVENUE
HOUSTON, TEXAS 77002

3

EXPLANATION OF ADJUSTMENTS ON EXHIBIT C

1. The deduction for contributions is reversed in order to arrive at net income before such deduction. An adjusted amount is allowed in item 11.

2. Municipal bond interest is includable in the determination of adjusted net income for franchise tax purposes.

3 & 6. Percentage depletion is reversed with cost depletion allowed since percentage depletion is not an allowable deduction for Wisconsin tax purposes.

4 & 5. Federal depreciation expense is reversed with Wisconsin depreciation expense being allowed.

7. The reserve basis for bad debt deduction is disallowed with actual bad debts being allowed as a deduction. See schedule 1.

8 & 9. The federal treatment of carved out production is reversed so that the book method is allowed. This corresponds to the crude oil barrel data used in the E section of this report.

10 & 11. Federal income taxes and contributions, subject to statutory limitations, are allowed as deductions. A federal contribution carry-forward is not allowed in 1965 since it was allowed in 1964 for Wisconsin tax purposes.

Exhibit C-1

Humble Oil & Refining Company

Reconciliation of Surplus per Books with Book Income
and With Federal Taxable Income Before Special Deductions

Calendar Year	1965	1966	1967	1968
Capital Surplus - End of Year	448,457,004.00	229,164,883.00	229,164,883.00	229,164,883.00
Retained Earnings-Appropriated-End of Year	75,459.00	75,459.00	75,459.00	75,459.00
Unappropriated-End of Year	2,247,814,818.00	2,457,956,[illegible].00	2,687,831,092.00	2,665,814,127.00
Total Surplus - End of Year	2,696,347,281.00	2,687,197,214.00	2,917,071,434.00	2,895,054,469.00
- Beginning of Year	2,508,911,332.00	2,696,347,281.00	2,687,197,214.00	2,917,071,434.00
Increase or (Decrease)	187,435,949.00	(9,150,067.00)	229,874,220.00	(22,016,965.00)
Surplus Adjustments:				
Dividends Paid	275,000,000.00	325,000,000.00	370,000,000.00	390,000,000.00
Spin-off of Chemical Division (Jan through May net income)		10,286,762.00		
Oklahoma Oil Company Surplus Reinstatement		(1,436.00)		
Transfer Enjay Chemical Company stock to parent		219,292,121.00		
Interperiod Tax Allocation				238,685,000.00
Book Income	462,435,949.00	545,427,380.00	599,874,220.00	606,668,035.00
Taxpayer Adjustments:				
Federal Income Tax	34,792,919.00	60,582,992.00	95,891,632.00	145,829,527.00
Taxable Income Not Recorded on Books this Year	61,141,304.00	49,494,005.00	62,930,329.00	51,121,034.00
Expenses Recorded on Books This Year Not Deducted on Returns	283,914,823.00	293,465,435.00	292,676,782.00	366,221,121.00
Income Recorded on Books This Year Not Included in Returns	(60,264,848.00)	(64,377,063.00)	(58,335,718.00)	(63,453,930.00)
Deduction in Returns Not Charged Against Book Income This Year	(569,801,915.00)	(598,016,586.00)	(624,078,013.00)	(696,811,018.00)
Federal Taxable Income Before Special Deductions	212,218,232.00	286,576,163.00	368,959,232.00	409,574,769.00

Humble Oil & Refining Company

Apportionment Summary

Exhibit E 5

Calendar Year	1965 Percent to Wisconsin	1965 Weight	1965 Weighted Percent	1966 Percent to Wisconsin	1966 Weight	1966 Weighted Percent	1967 Percent to Wisconsin	1967 Weight	1967 Weighted Percent	1968 Percent to Wisconsin	1968 Weight	1968 Weighted Percent
Tangible Property E-1	.6213	1.	.6213	.6614	1.	.6614	.7279	1.	.7279	.6600	1.	.6600
Cost of Manufacture E-2	0	.614609	0	0	.584715	0	0	.560530	0	0	.551643	0
Sales E-3	.4431	1.	.4431	.4974	1.	.4974	.5350	1.	.5350	.5009	1.	.5009
Totals		2.614609	1.0644		2.584715	1.1588		2.560530	1.2629		2.551643	1.16[illegible]
Average Percent to Wisconsin			.4071			.4483			.4932			.4[illegible]

Humble Oil & Refining Company

Tangible Property

Exhibit E-1 6

Calendar Year	1965 Wisconsin	1965 Total	1966 Wisconsin	1966 Total	1967 Wisconsin	1967 Total	1968 Wisconsin	1968 Total
Property, Plant & Equip.	15,997,053.00	5,479,265,380.00	18,017,771.00	5,468,933,943.00	19,315,704.00	5,869,578,562.00	18,099,813.00	6,384,181,607.00
Reserve for Depreciation	(4,327,701.00)	(2,517,148,126.00)	(3,978,022.00)	(2,474,556,422.00)	(4,082,910.00)	(2,632,968,493.00)	(4,732,797.00)	(2,778,976,854.00)
Inventory	358,302.00	283,585,012.00	338,632.00	249,253,431.00	485,439.00	283,610,662.00	301,290.00	292,598,334.00
Total-Per Books	12,027,654.00	3,245,702,266.00	14,378,381.00	3,243,630,952.00	15,718,233.00	3,520,220,731.00	13,668,306.00	3,897,803,087.00
Adjustments:								
Incomplete Construction	(415,118.00)	(140,571,141.00)	(921,250.00)	(145,572,043.00)	(259,800.00)	(212,151,698.00)	(48,759.00)	(249,477,552.00)
Intangible Development Costs		(603,718,676.00)		(608,058,778.00)		(598,705,539.00)		(583,802,869.00)
Non-Apportionable Income Property-Exhibit E-1.1(A)		(594,905,310.00)		(596,863,519.00)		(622,658,009.00)		(742,680,554.00)
Total, End of Year	11,612,536.00	1,906,507,139.00	13,457,131.00	1,893,136,612.00	15,459,033.00	2,086,705,485.00	13,619,547.00	2,321,842,112.00
Beginning of Year	10,855,359.00	1,716,878,382.00	11,612,536.00	1,906,507,139.00	13,457,131.00	1,893,136,612.00	15,459,033.00	2,086,705,485.00
Total	22,467,895.00	3,623,385,521.00	25,069,667.00	3,799,643,751.00	28,916,164.00	3,979,842,097.00	29,078,580.00	4,408,547,597.00
Average	11,233,948.00	1,811,692,761.00	12,534,834.00	1,899,821,876.00	14,458,082.00	1,989,921,049.00	14,539,290.00	2,204,273,799.00
Average Non-Apportionable Marine Property		(3,550,000.00)		(4,700,000.00)		(3,550,000.00)		(1,200,000.00)
Total Tangible Property	11,233,948.00	1,808,142,761.00	12,534,834.00	1,895,121,876.00	14,458,082.00	1,986,371,049.00	14,539,290.00	2,203,073,799.00
Percent to Wisconsin	.6213		.6614		.7279		.6600	

Humble Oil & Refining Company — Exhibit E-1.1 — 6

Non-Apportionable Tangible Property

	Calendar Year		1965	1966	1967	1968
	Net Book Tangible Property - Exploration & Production Dept.		1,706,763,830.	1,744,636,397.	1,807,551,391.	2,027,759,776.
	Adjustments:					
	Incomplete Construction		(69,091,760.)	(71,199,406.)	(84,679,670.)	(95,579,598.)
	Intangible Development Costs		(603,718,676.)	(608,058,778.)	(598,705,539.)	(583,802,869.)
1.	Investment in Mineral Interests		(12,508,013.)	(12,007,489.)	(13,869,313.)	(12,392,691.)
	Net Value of Gas Plants		(129,768,000.)	(141,876,000.)	(165,564,000.)	(199,029,500.)
	Adjusted Tangible Property		891,677,381.	911,494,724.	944,732,869.	1,136,955,124.
	Non-Apportionable Percentage	E-1.2(E)	65.3148	64.1645	64.4403	64.2319
	Non-Apportionable Tangible Property		582,397,897.	584,856,030.	608,788,696.	730,287,863.
1.	Investment in Mineral Interests		12,508,013	12,007,489.	13,869,313.	12,392,691.
A.	Total Non-Apportionable Tangible Property		594,905,310.	596,863,519.	622,658,009.	742,680,554.

HUMBLE OIL AND REFINING COMPANY — 7

EXPLANATION OF ADJUSTMENTS ON EXHIBIT E-1

Net tangible property per books is used to compute this factor. To this amount, construction in progress or incomplete construction is removed. Intangible development cost is removed since it has already been deducted for tax purposes. Net property used in producing non-apportionable income is also removed.

Humble Oil & Refining Company

Exhibit E-1.2 9

Non-Apportionable Percentage

Calendar Year		1965	1966	1967	1968
Natural Gas Net Income	E-4.2(E)	57,632,537.	80,043,000.	95,838,701.	110,674,128.
Adjusted Exploration & Production Department Net Income	E-4.1(B)	270,378,649.	355,731,829.	439,814,865.	484,329,850.
A. Percent of Gas Net Income to Department Net Income		21.3155	22.5009	21.7907	22.8510
B. Reciprocal of above (A.) which represents the remaining net income of the department, part of which is non-apportionable.		78.6845	77.4991	78.2093	77.1490
C. Non-Apportionable Percentage *		55.9186	53.7601	54.5326	53.6376
D. Non-Apportionable Portion of Line B (B x C)		43.9993	41.6636	42.6496	41.3809
E. Non-Apportionable Percentage of the Exploration & Production Department (A + D)		65.3148	64.1645	64.4403	64.2319

* These figures come from Crude Oil Barrelage Data prepared by the company. The computation includes barrels of crude oil produced, purchased, sold, and refined. From all of this barrel data, a percentage figure is determined which represents barrels produced or purchased and refined which becomes subject to apportionment and a percentage figure for barrels produced or purchased and sold without refining and therefore become non-apportionable. The percents used here are as compiled by the company and represent the non-apportionable portion.

A. 614

Humble Oil & Refining Company

Cost of Manufacturing Weight

Exhibit E-2 10

Calendar Year		1965	1966	1967	1968
A. Net Sales Producing Apportionable Income	E-3(C)	2,909,203,584.	2,886,471,545.	3,056,136,204	3,271,188,357.
Resale of Purchased Products: Refined Products		664,012,777.	771,008,810.	849,385,388.	962,451,462.
Automotive T.B.A.		76,212,086.	80,200,078.	89,273,707.	98,758,015.
Crude Oil	E-3.1(B)	388,662,454.	347,499,759.	404,422,321.	405,451,903.
B. Net Sales of Taxpayer's Manufactured Products		1,800,316,267.	2,687,763,498.	1,713,054,788.	1,804,526,977.
C. Cost of Manufacturing Weight (B ÷ A)		61.4609	58.4715	56.0530	55.1642

A. 615

HUMBLE OIL AND REFINING COMPANY

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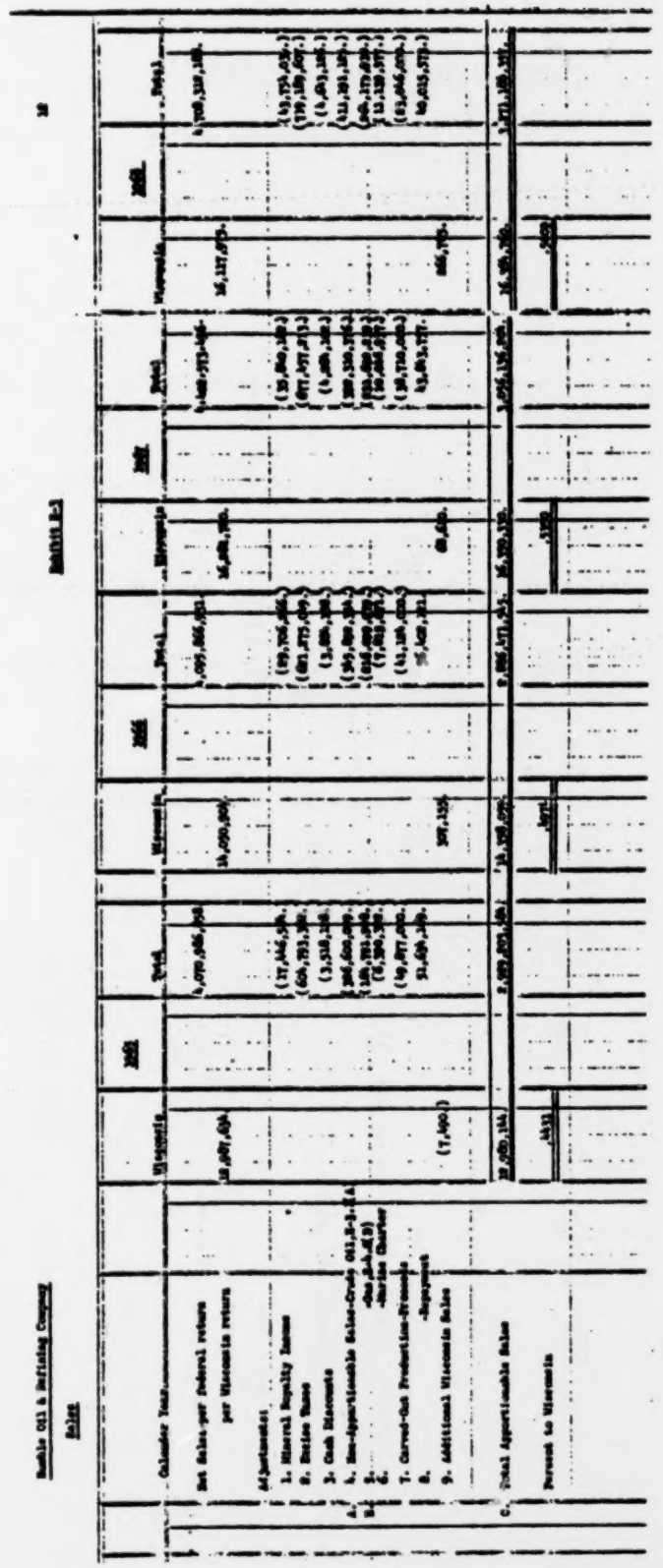
EXPLANATION OF ADJUSTMENTS ON EXHIBIT E-2

Since the company sells both its own manufactured products and also sells finished products from other manufacturers, the cost of manufacturing factor has been weighted based on the ratio of the sales of the company's own products to total apportionable sales.



HUMBLE OIL AND REFINING COMPANY

EXPLANATION OF ADJUSTMENTS ON EXHIBIT E-3

To net sales per federal return, the following adjustments are made:

1, 4, 5 & 6. Sales generated from non-apportionable income sources are eliminated.

2. Product taxes collected and remitted to the respective governments are eliminated.

3. Cash discounts are eliminated to arrive at net sales.

7 & 8. Carved out production income is converted back to the book basis of reporting income.

9. A minor adjustment is made to Wisconsin sales reported per returns to agree with the book sales reconciliation.

Exhibit E-3.1

Humble Oil & Refining Company

Sales of Crude Oil - Produced and Purchased

Calendar Year	1965	1966	1967	1968
Crude Oil & Condensate Sales of the Explo. & Production Dept. Before Consolidation, per Books	584,063,440.	643,399,758.	719,405,230.	766,609,853.
Non-Apportionable Percent	55.9186	53.7601	54.5326	53.6376
A. Sales Generating Non-Apportionable Income (Produced)	326,600,099.	345,892,354.	392,310,376.	411,191,125
Crude Oil & Condensate Sales of the Refining Dept. to Outsiders, per books	715,262,553.	693,392,113.	796,732,697.	816,643,088.
Sales Generating Non-Apportionable Income (Above)	326,600,099.	345,892,354.	392,310,376.	411,191,125.
B. Sales of Purchased Crude Oil & Condensate	388,662,454.	347,499,759.	404,422,321.	405,451,903.

Humble Oil & Refining Company

Non-Apportionable Income - Total Company

Exhibit E-4 15

Calendar Year		1965	1966	1967	1968
Income Which Follow Situs of Property:					
Gain on Disposal of Tangible Property		6,085,146.	(3,874,045.)	2,446,373.	7,307,344.
Casualty Losses		(185,384.)	(381,629.)	(298,038.)	(415,452.)
Tangible Property Retirement Losses		(3,842,405.)	(3,143,950.)	(3,186,558.)	(6,032,562.)
Material Disposal Losses		(129,181.)	(488,273.)	(743,541.)	(200,762.)
Gain on Sale of Stock Material		33,087.	2,594.	25,255.	
Land Sales		415,472.			
Departmental Non-Apportionable Income-					
Mineral Royalty	E-4.1(A)	15,753,908.	27,586,433.	33,502,756.	41,273,481.
Natural Gas	E-4.2(E)	57,632,537.	80,043,000.	95,838,701.	110,674,128.
Crude Oil	E-4.2(G)	101,859,386.	128,117,835.	162,305,866.	172,264,819.
Marine		500,000.	1,400,000.	3,100,000.	3,000,000.
Subtotal		178,122,566.	229,261,965.	292,990,814.	327,870,996.
Income Which Follow Residence:					
Dividend Income		15,930,203.	19,283,820.	18,100,446.	11,793,488.
Interest Income		7,420,576.	7,743,796.	6,038,200.	4,059,210.
Interest Expense		(5,683,425.)	(13,871,111.)	(5,150,609.)	(13,025,928.)
Net Dividends & Interest Income		17,717,354.	13,156,505.	18,988,037.	2,826,770.
Royalties-Net		191,892.	235,439.	163,444.	76,989
Subtotal		17,909,246.	13,391,944.	19,151,481.	2,903,759.
A. Total Non-Apportionable Income		196,031,812.	242,653,909.	312,142,295.	330,774,755.
Administrative Allocation	E-4.3(D)	(459,596.)	(1,411,371.)	(1,000,193.)	(2,256,279.)
Net Non-Apportionable Income		195,572,216.	241,242,538.	311,142,102.	328,518,476.
Federal Income Taxes (Ratio from E-4.4)		(3,221,270.)	(19,901,303.)	(31,114,210.)	(32,851,848.)
Non-Apportionable Income		192,350,946.	221,341,235.	280,027,892.	295,666,628.

A. 620

A. 621

HUMBLE OIL AND REFINING COMPANY

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EXPLANATION OF ADJUSTMENTS ON EXHIBIT E-4

Non-apportionable income is computed as follows:

1. All gains or losses on sales or disposals of tangible property is included.
2. The income from non-apportionable sources is included.
3. Interest, dividend and royalty income, net of related expenses is included.
4. Administrative expense and federal income taxes has been allocated to non-apportionable income.

Humble Oil & Refining Company

Exploration and Production Department
Adjusted Net Income

Exhibit E-4.1 17

	Calendar Year		1965	1966	1967	1968
	Exploration & Production Department:					
	Federal Taxable Income per Department		84,961,341.	144,291,651.	214,288,951.	236,775,467.
	Adjustments:					
	Depletion		201,293,597.	217,437,784.	251,808,214.	268,869,241.
	Depletion		(222,807.)	(232,443.)	(271,496.)	(663,036.)
	Depreciation		1,686,108.	4,577.	992,889.	1,555,221.
	Carved-Out Production		1,757,169.	15,278,121.	5,133,757.	16,969,573.
	Gain or Loss on Tangibles		(3,401,266.)	6,262,483.	1,188,168.	467,608.
	Casualty Losses		98,638.	301,612.	271,554.	376,860.
A.	Mineral Royalty Net Income		(15,753,908.)	(27,586,433.)	(33,502,756.)	(41,273,481.)
	Interest Income		(179,056.)	(153,048.)	(126,001.)	(63,297.)
	Dividend Income		(56.)	(19.)	(56.)	(75.)
	Interest Expense		98,517.	69,021.	24,215.	21,417.
	Contributions		40,372.	58,523.	66,826.	1,294,352.
B.	Adjusted Departmental Net Income		270,378,649.	355,731,889.	439,814,265.	484,389,850.

A. 622

Humble Oil & Refining Company

Departmental Non-Apportionable Net Income -
Natural Gas and Crude Oil

Exhibit E-4.2 18

	Calendar Year		1965	1966	1967	1968
	Exploration and Production Department:					
	Net Sales per federal return		882,627,799.	974,831,438.	1,093,783,538.	1,182,864,191.
	Adjustments:					
	Mineral Royalties - Gross		(17,446,584.)	(89,706,266.)	(35,840,182.)	(43,754,039.)
	Carved-Out Production		1,757,169.	15,278,121.	5,133,757.	16,969,573.
A.	Adjusted Departmental Net Sales		866,938,344.	960,403,293.	1,063,077,107.	1,156,079,725.
B.	Adjusted Departmental Net Income	E-4.1(B)	270,378,649.	355,731,889.	439,814,265.	484,389,850.
C.	Ratio of Net Income to Net Sales (B ÷ A)		31.1878	37.0398	41.3718	41.8941
D.	Non-Apportionable Sales of Natural Gas	E-3 (B)	184,791,928.	216,099,979.	231,652,239.	264,175,930.
	Ratio (C)		31.1878	37.0398	41.3718	41.8941
E.	Non-Apportionable Net Income from Natural Gas		57,632,537.	80,043,000.	95,838,701.	110,674,128.
F.	Non-Apportionable Sales of Crude Oil	E-3.1 (A)	326,600,099.	345,892,354.	392,310,376.	411,191,185.
	Ratio (C)		31.1878	37.0398	41.3718	41.8941
G.	Non-Apportionable Net Income from Crude Oil		101,859,386.	128,117,835.	162,305,866.	172,264,819.

A. 623

Exhibit E-4.3 19

Humble Oil & Refining Company

Administrative Allocation to
Non-Apportionable Income

Calendar Year		1965	1966	1967	1968
A. Gross Non-Apportionable Income	E-4 (A)	196,031,812.	242,653,909.	312,142,295.	330,774,755.
B. Adjusted Net Income Before Federal Income Taxes & Contributions	Exhibit C(A)	413,898,996.	516,864,728.	605,358,288.	689,195,487.
C. Ratio of B ÷ A		47.3623	46.9473	51.5632	47.9943
Administrative Department Operating, Selling & Administrative Expenses		970,383.	3,006,287.	1,939,741.	4,701,140.
Ratio (C)		47.3623	46.9473	51.5632	47.9943
D. Non-Apportionable Income Allocation		459,596.	1,411,371.	1,000,193.	2,256,279.

A. 624

Exhibit E-4.4 20

Humble Oil & Refining Company

Non-Apportionable Income - Wisconsin

Calendar Year	1965	1966	1967	1968
Income Which Follows Situs:				
Gain or Disposal of Tangible Property	(90,327.)	(61,620.)	(7,152.)	69,640.
Casualty Losses	(11,960.)	(9,530.)	(22,711.)	(21,549.)
Total Non-Apportionable Income	(102,287.)	(71,150.)	(29,863.)	48,091.
Federal Income Taxes *	1,685.	5,870.	2,986.	(4,809.)
Non-Apportionable Income	(100,602.)	(65,280.)	(26,877.)	43,282.

* Ratio of Federal Income Tax Deduction on Exhibit C to Adjusted Net Income Before Such Deduction
1965 - 1.6471 %
1966 - 8.2495 %
1967 -10. %
1968 -10. %

A. 625

Schedule 1

Humble Oil & Refining Company

Bad Debts

Calendar Year	1965	1966	1967	1968
Balances - End of Year	7,691,170.	9,950,850.	13,208,238.	15,533,782.
	383,210.	1,962,098.	2,734,861.	4,316,907.
	4,167,118.			
Total - End of Year	12,241,498.	11,912,948.	15,943,099.	19,850,689.
Beginning of Year	9,308,697.	12,241,498.	11,912,948.	15,943,099.
Increase or (Decrease)	2,932,801.	(328,550.)	4,030,151.	3,907,590.
Exhibit C-1 Adjustment:	(734,279.)	(734,279.)	(734,279.)	(734,279.)
Exhibit C Adjustment	3,667,080.	402,729.	4,764,430.	4,641,869.

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EXHIBIT 8

if they were really convinced they were right, I wouldn't expect that they would agree so easily.

Q That is your conclusion?

A Yes.

Q He didn't say that?

A No.

Q Do you recall a letter from someone at Humble with the settlement indicating that they did not agree to the apportioning of their income, but were paying the tax anyway?

A Very much.

Q Do you recall such a letter?

A ~~Do I recall -- yes, probably also some telephone calls.~~

Q When you began the audit did you verify the sales reported on a separate accounting basis?

A How do you mean verify?

Q Well, did you audit the reported sales?

A Back to their source documents, no; back to their printouts, yes, as I recall.

Q Did you have any reason to challenge the amount of Wisconsin sales reported?

A No, not that I recall; no reason to.

Q That on a separate accounting basis the sales reported were accurately reflected?

A ~~I think there were -- there were minor adjustments, as~~

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so I have to see what was done on the original report.

Wisconsin sales we accepted as they were.

Q Did you audit the reported cost of sales in Wisconsin?

A I don't know what you mean by "did we audit it."

Q Well, the tax returns showed gross sales.

A Did we go back and check the purchase invoices and see if they really made the purchases and made the expenses, no.

Q You did not?

A We didn't go back to source documents. We relied on information provided us by Humble.

Q Did you satisfy yourself that the cost of sales reported accurately reflected Humble's cost of sales in Wisconsin on a separate accounting basis?

A I would like to check the work papers. What we did was to trace the numbers that Humble used in the return back to their source — their print-outs — so we verified that the numbers on the return came from some substantial source. That's all we did; in other words, they were supported by something, whether they were in fact — whether the cost of the sales reported on the return was accurate, whether the numbers that they put into their print-outs actually represented the Wisconsin cost of sales, no, we didn't substantiate that.

Q For what reason didn't you substantiate it?

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A Because you have got to place some reliance on company documents. I assume the company is audited by a CPA. They have their own auditing staff. There are times when you can't audit everything, so there are things that, for practical purposes, you are forced to accept.

This is something we are probably -- you have got to make a decision in the course of an audit what can you accept as being reasonable and what can you not.

Q In other words, you have no basis for any position that the cost of sales reported by Humble for the years 1960 through 1964 on its Wisconsin return were anything other than accurate?

A As put together for that return purposes, for that —

Q On a separate accounting basis.

A We disputed the basic method of determining income. We dispute the facts that when you put that return together the way it was that it produced a result that was accurate.

Q So you didn't bother to really check to see whether that separate accounting basis was accurate or not?

A Yes, I did.

Q And you came up with no facts —

A In my opinion it was — it was — the costs shown there could be traced back to a document.

Q So you found no basis on which to challenge the cost of sales figure used on the return for the purposes of a separate accounting reporting procedure?

A That's right.

Q All right.

A But I disputed the fact that that produced the result that was equitable.

Q When did you come to that conclusion?

A After we determined that the company was unitary.

Q And when did you come to that conclusion?

A After I returned from Humble and discussed all the facts with my supervisor and my section chief and legal counsel.

Q Let's pin that down to a point in time. Was that in 1966?

A It had to be prior to the date of the report of September 9, the fall of '66.

Q What verification did you make or attempt to make as to the accuracy of the expenses reported on the Humble returns for 1960 through 1964?

A All expenses, particular expenses, or any one expense?

Q Just generally what verification procedures did you use?

A I did not go to any source documents to check the travel expense of Joe Bloke or the sales manager in Wisconsin

or what-have-you.

Q So you had no basis on which to, in effect, challenge the accuracy of any of the expenses reported?

A I was willing to accept in that respect what was reported, and while you have -- well, you have got to go back a bit. Once you are at a point that a company is unitary, it is no longer very important to establish that John Smith spent a hundred dollars more than he should have, because if you disallow a hundred dollars and multiply that times the per cent of this company's income to Wisconsin, you are going to tax about a nickel, so it isn't practical.

You don't do that as a practical audit step in the audit of big corporations where your apportionment percentage is that small.

Q My point is that based upon your examination, your audit work papers that you prepared, your audit report, you do not have facts to challenge any of the separate accounting figures reported on the Humble returns?

A Oh, I wouldn't say that at all.

Q Well, you have just testified -- you testified you verified the sales

A You are talking about costs.

Q -- and decided not to challenge the sales as reported in Wisconsin?

in which they were computed; and as I said, I had some questions about that, the area accounting, area credit, area marketing, other area expense, other functional services, administrative in general, total $883,769 out of $1,700,000, over half of $1,700,000 of indirect -- of expenses, I had questions about that.

Q I mean, this is a question that you say they are overstated or understated or what?

A Overstated.

Q Overstated by how much?

A That is the question.

Q Well, don't you know? You say there is $800,000 there.

A They could be overstated. Who can say, because at this point, as I started to say before, I went back to Madison and we went over the information that we had regarding unitariness, we decided that in our opinion the company was unitary. Once you reach that point, it doesn't matter. You lose interest in these other items because they become unimportant. You determine that this company cannot compute its income and file its tax return on this basis, so it no longer makes any sense to go back and try to correct a number that you are not going to use anyway.

Q Well, now, let's just pursue this separate accounting business. That is the way the tax return is reported

and I am trying to determine how much auditing you did.

A Quite a lot.

Q You said you audited the sales and you concluded that you couldn't adjust the sales. You said you have no basis for adjusting the cost of sales. Now of these expenses that you claim that you have questions on, how substantial are these questions?

A That could be -- this could be 50% off.

Q You have $800,000 of those --

A $400,000 off, it could be.

Q Let's look at the front of the return, and let's assume for a minute that those were $400,000 overstated. The return shows a taxable loss of $842,000. There still wouldn't have been any tax due to the State of Wisconsin, would there?

A If that was the only adjustment.

Q What else would there be an adjustment to?

A Everything else.

Q Everything? Well, like what?

A Adjustments to cost -- there could be adjustments to all these other expenses.

Q But you don't have any facts -- you have previously said you wouldn't even challenge any of these other expenses. If you have something specific, I would like to know what it is.

A I told you, and that is what I have told you is once you determine that a company is unitary, this method of computing income is not valid. It does not produce an accurate result, so to tear apart any individual number is meaningless.

Q It did not produce any income for the State of Wisconsin, right?

A You bet your life it did not.

Q So the apportionment would appear to be the only way to produce any income to the State of Wisconsin?

A That was a result, yes. I have audited a lot of companies where it was producing nothing.

Q It didn't work that way with the oil companies, did it?

A Unfortunately or fortunately, depending on your point of view, it didn't.

Q Now, do you recall or can you tell from your work papers whether you had any questions relating to the sales, the cost of sales on the other four years, 1960, 1961, '62, '63?

Q I would say not. Once you determine a company is unitary, an audit procedure — my audit procedure calls for not spending any more time on something that is not important. We don't have time to audit things that are not important. This is only one company out of 50,000 or more.

Q All right. The company during this period was incurring at least in some of the years fairly substantial losses as evidenced by the 1964 return, is that not correct?

A I don't think that return evidences anything.

Q As reported on the returns?

A Yes.

Q You are entitled to your own opinion as to whether they were in fact incurring losses, but now based upon your accounting background if the sales of the company in Wisconsin are accurately reflected, and if you can't find any basis for challenging the cost of sales and if the expenses, even if they were 50% overstated, wouldn't have produced taxable income, any way you slice it on a separate accounting basis you are not going to come out with taxes for the State of Wisconsin, are you?

A Absolutely, but that is not the way to slice it.

Q If separate accounting then wouldn't produce any taxable income, then the only way you can get taxable income is if you pull it in from outside of the State, is that correct?

A No. We feel that the apportionment --

Q You have answered the question.

A If your formula is reasonable, the courts have held that the income produced by that formula is taxable.

EXHIBIT 11-7A

WT-IC-100 — **WISCONSIN CORPORATION FRANCHISE OR INCOME TAX RETURN** FORM 4

FOR RAISING STATE, COUNTY AND MUNICIPAL REVENUES

RECEIVED 1965

Exhibit 7A 2997

For the 12th day of the third month following the close of the taxable year. Mail to: WISCONSIN DEPARTMENT OF TAXATION, Corporation Franchise and Income Tax Section, Post Office Box 59, Madison, Wisconsin 53701

For calendar or fiscal taxable year: Beginning _____ Ending _____

LEAVE BLANK

File No. 79-40723

Type 34

Form 4-65 4F5

WIS CORPORATION FRANCHISE & INCOME TAX SECTION

10-2-71 KC

A. Name: Humble Oil & Refining Company

B. Mailing Address (Number and Street): 800 Bell Avenue

City: Houston

State: Texas

C. Zip Code: 77002

D. State of Incorporation: Delaware

E. Year of Incorporation: 1959

F. Principal Business Activity: All phases of the petroleum industry.

G. Principal Product or Service: Petroleum and its products

H. Bus. Code No.: 1310

I. If all your income is derived from within one municipality, complete Schedule J and E. If your income is derived from more than one municipality, complete Schedule J, page 4.

J. City ☐ Village ☐ or Town ☐ of

K. County of

Leave Blank: C MADIS

IMPORTANT — PLEASE REFER TO INSTRUCTION BOOKLET WT-IC-100

INCOME	1. Gross receipts or gross sales, less returns and allowances	12,987,634
	2. Cost of goods sold (Schedule A) or cost of operations (attach schedule)	8,986,232
	3. Gross profit	4,001,402
	4. Profits (losses) from disposal of capital assets (Schedule B) — FIELD AUDITED — (Loss)	(90,327)
	5. Gross dividends (Schedule C)	-
	6. All other income (Schedule D)	731,224
	7. Total income from all sources	4,642,299
DEDUCTIONS	8. Compensation of officers (Schedule E)	
	9. Wages and bonuses	1,435,464
	10. Repairs	257,107
	11. Rent	527,772
	12. Depreciation (Schedule F)	504,177
	13. Depletion and amortization (attach schedule)	36,410
	14. Other taxes (Schedule G)	90,734
	15. Taxes (Schedule H)	338,865
	16. Deductible dividends received (Schedule C)	
	17. Interest	3,120
	18. Other ordinary and necessary expenses (Schedule I)	2,269,970
	19. Total (lines 8 through 18)	5,463,619
	20. Subtotal (line 7 minus line 19) (Loss)	(821,320)
	21. U.S. income taxes (not in excess of 10% of line 20) (Schedule X)	-
	22. Subtotal (Loss)	(821,320)
	23. Contributions (not in excess of 5% of line 22) (Schedule Y)	-
	24. Subtotal	(821,320)
	25. Unused 1963 net business loss offset	-
	26. 1964 net business loss offset	-
	27. Net income (Loss)	(821,320)

TO BE COMPLETED ONLY BY CORPORATIONS REPORTING ON THE APPORTIONMENT METHOD (Form 4B)

Leave Blank

APPORTIONMENT	28. Total company net non-apportionable income (loss)	
	29. Apportionable income (line 27 minus line 28)	
	30. Per cent to Wisconsin	%
	31. Amount to Wisconsin	
	32. Wisconsin net non-apportionable income (loss)	
	33. Wisconsin net income	
	34. Wisconsin sales $	0 1 2 3 4 5 6 7

		Franchise Tax	Income Tax	Leave Blank
TAX	35. Total tax (see instruction F)	None	None	
	36. Less: Declaration installments paid (Form 4-ES)	2,500		
	37. Other payments and credits			
	38. Balance due — attach remittance			
	39. Overpayment — complete line 40	2,500		

CHECKED BY COMPTOMETER

40. Enter amount of overpayment you want credited on 1966 estimated tax $ 2,500.00 refunded $

PT 3 1965 1966 .00 e

2977 - 2997

Page 2

Schedule A — COST OF GOODS SOLD (See Instruction 2)

1. Inventory at beginning of year (complete lines 8 and 9)	519,103
2. Merchandise purchased for manufacturing	-
3. Merchandise purchased for resale	8,823,042
4. Cost of manufacturing (submit schedule)	-
5. Total	9,342,145
6. Inventory at end of year	355,913
7. Cost of goods sold to line 2, page 1	8,986,232

8. Have you included Form 107 Yes ☐ No ☐ See General Instruction K-4

9. Has your method of inventory valuation changed? Yes ☐ No ☒ If yes, attach explanation.

Schedule B — PROFITS (LOSSES) FROM DISPOSAL OF CAPITAL ASSETS (See Instruction 4)

Kind of Property	Sites: Wis.	Sites: Out-side	Cost or Other Basis	Depreciation Allowed or Allowable	Net Tax Cost	Gross Sales Price less Expense of Sale	Profit (Loss)
Service Stations	X		242,043	35,944	206,099	115,772	(90,327)
Total to line 4, page 1						(Loss)	(90,327)

Schedule C — DIVIDENDS (See Instruction 5)

Name of Declaring Corporation	Gross Dividends	Deductible Dividend Received
Gross dividend income to line 5, page 1	None	
Deductible dividends received to line 16, page 1		None

Schedule D — ALL OTHER INCOME (See Instruction 6)

1. Rent	641,772
2. Royalties from tangible property	
3. Royalties from patents and other intangible property	
4. Interest from securities (except amounts required on line 5)	
5. Interest from obligations of the United States and its instrumentalities*	
6. All other interest	
7. Collections of accounts written off in previous years	
8. Tax refunds	
State Gasoline Tax Allowance	45,720
Other Income	43,732
Total to line 6, page 1	731,224

CHECKED BY COMPTOMETER

*Interest from obligations of the United States and its instrumentalities is not taxable income for corporations subject to income tax. See introduction to instruction booklet.

WT-IC-830

2978

The State of Wisconsin

DEPARTMENT OF TAXATION

IN REPLY PLEASE REFER TO:
CORPORATION FRANCHISE AND
INCOME TAX SECTION
POST OFFICE BOX 59
MADISON, WISCONSIN 53701

Re: 99-40723

February 28, 1967

Humble Oil & Refining Company
Tax Department
Houston, Texas 77001

RECEIVED
MAR 2 1967
HEADQUARTERS
TAX DEPARTMENT

Attention: R. F. Heidner, Jr.
In regard to:
Your letter of: February 21, 1967

We have received your request for an extension of time in which to file:

[X] A 1966 Wisconsin corporation franchise or income tax return, Form 4.

[ ] A complete 1966 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1966 return filed? Yes [ ] No [ ]

[ ] A 1966 Inventory report Form 10.

An extension of time to April 15, 1967 is hereby granted for the filing of your return(s) as indicated.

TAX RETURN - FORM 4

The maximum extension permitted by Section 71.10 (5) of the Wisconsin Statutes is 30 days, and your return will be considered timely filed if it is received on or before the date shown above. If no return is filed by that time the statutory $10.00 late filing fee will be assessed.

INVENTORY REPORT - FORM 10

This 30 day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

TAX PAYMENT

Any corporation franchise or income tax that is computed to be due on the complete return which was not paid by the original due date will be subject to extension interest at the rate of 5% per annum from the original due date to the end of the extension period, or the date of payment whichever is earlier. Any amount of tax computed to be due on the complete return that is not paid by the end of the extension period will be considered delinquent as of that date and will be subject to a 2% delinquent penalty and delinquent interest will be added at the rate of 1% per month from the date of delinquency until the date of payment.

ADDITIONAL TIME TO FILE THE COMPLETE FORM 4

If it is impossible to file a complete Form 4 within the extension period granted, a tentative return should be filed prior to the expiration of the extension period, and the complete return filed within 60 days after the close of the extension period. If the tentative return is filed within the extension period and the complete return is filed more than 60 days after the close of the extension period the 25% negligence penalty may be imposed unless it can be shown that the delayed filing was due to reasonable cause and not to negligence. Complete returns filed more than 60 days after the close of the extension period should contain a statement explaining the reason for the delayed filing.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

NOTE: Enclose one copy of this notice with your return.

2978

DECLARATION OF ESTIMATED TAX
(This Form To Be Filed At The Address Shown Above)

Form 4-ES

1966

Leave This Space Blank

File No. 99-40723

Corporation name Humble Oil & Refining Company

Corporation address 800 Bell Avenue, Houston, Texas 77002

This declaration is for: (Check one)
[X] Calendar year 1966
[ ] Fiscal year beginning _____ 19___ and ending _____ 19___

1.	1965 Wisconsin corporation franchise or income tax	$ None
2.	Estimate of 1966 Wisconsin corporation franchise or income tax	$ 2,500.00
3.	Deduct amount claimed for credit from overpayment of 1965 tax	$ 2,500.00
4.	Balance of estimated 1966 tax to be paid	$ None
5.	Computation of payment: Check proper box and enter amount of payment [ ] March 15, 1966, enter 1/4 of line 4 [ ] June 15, 1966, enter 1/3 of line 4 [ ] September 15, 1966, enter 1/2 of line 4 [ ] January 15, 1967, enter amount on line 4	$ None

If this declaration is due to be filed on [Fiscal year taxpayers see Instruction Booklet WT-IC-100]

I declare under the penalties of perjury that this declaration has been examined by me and to the best of my knowledge is a true, correct and complete declaration.

Signature R. F. Heidner, Jr. Title Assistant Secretary Date April 14, 1966

* Overpayment of estimated tax for 1965 is applied as payment in full of estimated tax for 1966.

2979

A. 640

2980

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
W. TRENT TURPIN
COORDINATOR
TAX COMPLIANCE

April 13, 1967

RECEIVED
APR 18 1967
WIS. DEPT. OF TAXATION
CORPORATION FRANCHISE
& INCOME TAX SECTION

Wisconsin Department of Taxation
Corporation Franchise and Income Tax Section
Post Office Box 98
Madison, Wisconsin 53701

Gentlemen:

Enclosed is the 1966 Wisconsin Corporation Franchise Tax Return for Humble Oil & Refining Company, which reflects a loss of $1,159,830 from Wisconsin operations during the calendar year 1966.

Please credit the overpayment of declaration installments against our 1967 estimated tax. We have enclosed completed Form 4-ES, Declaration of Estimated Tax, so that this can be accomplished.

We appreciate very much your cooperation in granting us an extension of time until April 15, 1967 within which to file the final return.

Yours very truly,

RF Heidner Jr.

R. F. Heidner, Jr.

TOF/mt

Attachments

A. 641

2981

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
LEE HILL
MANAGER
W. J. CRAWFORD
ASSISTANT MANAGER

May 18, 1965

RECEIVED
MAY 24 1965
Corporation
Wis. Dept. of Taxation

99-1,703

Wisconsin Department of Taxation
Corporate Income Tax Section
Post Office Box 98
Madison, Wisconsin 53701

Gentlemen:

Enclosed is completed form 4-ES, Declaration of Estimated Tax, for Humble Oil & Refining Company for the calendar year 1965 in accordance with your letter of May 12, 1965.

Please have the overpayment of our 1964 tax applied as payment in full of our estimated Wisconsin Income Tax for the calendar year 1965.

Yours very truly,

W. J. Crawford

RF Heidner Jr.

By: R. F. Heidner, Jr.

JWW/ral
Attachment

A. 642

2982

May 12, 1965

Humble Oil and Refining Company
P. O. Box 2180
Houston, Texas 77001

Gentlemen:

You recently filed your 1964 Wisconsin corporate income tax return showing a computation of an overpayment of 1964 income tax. You also requested transfer of this claimed overpayment of $2,500.00 to the declared tax.

You did not enclose a declaration of estimated income tax for the year 1965. In order that you may receive proper credit for this transfer, it will be necessary that you complete the enclosed Form 4ZS and return it, along with any necessary payment and the enclosed copy of this letter within ten days. Kindly address your reply to this section at the address shown on this letterhead.

CORPORATION INCOME TAX SECTION

FHJ:dmw
enc.

A. 643

2983

April 22, 1965

Humble Oil and Refining Company
P. O. Box 2180
Houston, Texas 77001

Gentlemen:

You recently filed your 1964 Wisconsin corporate income tax return showing a computation of an overpayment of 1964 income tax. You also requested transfer of this claimed overpayment of $2,500.00 to the declared tax.

You did not enclose a declaration of estimated income tax for the year 1965. In order that you may receive proper credit for this transfer, it will be necessary that you complete the enclosed Form 4-ZS and return it, along with any necessary payment and the enclosed copy of this letter within ten days. Kindly address your reply to this section at the address shown on this letterhead.

By_____
Kenneth F. Kleinschmidt

KFK:dmw
enc.

2984

The State of Wisconsin

DEPARTMENT OF TAXATION

IN REPLY PLEASE REFER TO
CORPORATION FRANCHISE AND
INCOME TAX SECTION
POST OFFICE BOX 59
MADISON, WISCONSIN 53701

February 24, 1966

Re: 99-40723

Humble Oil & Refining Company
P. O. Box 2180
Houston, Texas 77001

Attention: R. F. Heidner, Jr.
In regard to:
Your letter of: February 21, 1966

We have received your request for an extension of time in which to file:

[X] A 1965 Wisconsin corporation franchise or income tax return, Form 4.

[ ] A complete 1965 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1965 return filed? Yes[ ] No[ ]

[ ] A 1965 Inventory report Form 10.

An extension of time to April 15, 1966 is hereby granted for the filing of your return(s) as indicated.

The maximum extension permitted by Section 71.10 (5) of the Wisconsin Statutes is thirty days, and your return will be considered timely filed if it is received on or before the date shown above.

Section 71.10 (9) (a) of the Wisconsin Statutes provides, "Corporation franchise and income taxes not paid on or before the fifteenth day of the third month following the close of the income year, shall be deemed delinquent." This means that any portion of your 1965 Wisconsin corporation tax liability not paid by the extended due date listed above will be delinquent, and shall be subject to a 2% delinquent penalty, and delinquent interest at the rate of 1% per month computed from the due date (not the extended due date) of the return, until the date of payment. Any tax paid within the extension period shall be subject to extension interest computed at the rate of 5% per annum from the due date of payment.

If no return is filed by the extended due date the statutory $10.00 late filing fee will be assessed.

This thirty day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

If you find it impossible to file a complete Form 4 within the extension period granted above, you may file a tentative Form 4 within the extension period, provided the completed Form 4 is filed within sixty days after the close of the extension period. If you do file a timely tentative Form 4, and the completed Form 4 is not filed within sixty days after the close of the extension period the 25% negligence penalty provided by Section 71.11 (46) may be applicable.

NOTE: Enclose one copy of this notice with your return.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

WT-IC-830

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

2985

February 21, 1966

99-40723
Cal SA Del

Department of Taxation
State of Wisconsin
Madison 2, Wisconsin

Gentlemen:

Since the corporate books of Humble Oil & Refining Company are not closed until a late date, and since the information to be gathered for the preparation of financial statements, once the books are closed, is so voluminous, it would be very difficult to properly prepare and file the Wisconsin Corporation Income Tax Return by March 15, 1966.

We gratefully acknowledge your cooperation in prior years and shall appreciate very much your favorable consideration of this request for an extension until April 15, 1966 for filing this return.

A tentative return will be filed if requested.

Yours very truly,

RF Heidner Jr.
R. F. Heidner, Jr.

JWW/mt

RECEIVED
FEB 24 1966
WIS. DEPT. OF TAXATION
CORPORATION FRANCHISE
& INCOME TAX SECTION

2986

The State of Wisconsin

DEPARTMENT OF TAXATION

February 24, 1966

RECEIVED
MAR 1 1966
HEADQUARTERS
TAX DEPARTMENT

IN REPLY PLEASE REFER TO:
CORPORATION FRANCHISE AND
INCOME TAX SECTION
POST OFFICE BOX 59
MADISON, WISCONSIN 53701

Re: 99-40723

Humble Oil & Refining Company
P. O. Box 2180
Houston, Texas 77001

Attention: R. F. Heidner, Jr.
In regard to:
Your letter of: February 21, 1966

We have received your request for an extension of time in which to file:

☒ A 1965 Wisconsin corporation franchise or income tax return, Form 4.

☐ A complete 1965 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1965 return filed? Yes☐ No☐

☐ A 1965 Inventory report Form 10.

An extension of time to April 15, 1966 is hereby granted for the filing of your return(s) as indicated.

The maximum extension permitted by Section 71.10 (5) of the Wisconsin Statutes is thirty days, and your return will be considered timely filed if it is received on or before the date shown above.

Section 71.10 (9) (a) of the Wisconsin Statutes provides, "Corporation franchise and income taxes not paid on or before the fifteenth day of the third month following the close of the income year, shall be deemed delinquent." This means that any portion of your 1965 Wisconsin corporation tax liability not paid by the extended due date listed above will be delinquent, and shall be subject to a 2% delinquent penalty, and delinquent interest at the rate of 1% per month computed from the due date (not the extended due date) of the return, until the date of payment. Any tax paid within the extension period shall be subject to extension interest computed at the rate of 5% per annum from the due date of payment.

If no return is filed by the extended due date the statutory $10.00 late filing fee will be assessed.

This thirty day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

If you find it impossible to file a complete Form 4 within the extension period granted above, you may file a tentative Form 4 within the extension period, provided the completed Form 4 is filed within sixty days after the close of the extension period. If you do file a timely tentative Form 4, and the completed Form 4 is not filed within sixty days after the close of the extension period the 25% negligence penalty provided by Section 71.11 (46) may be applicable.

NOTE: Enclose one copy of this notice with your return.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

WT-IC-830

Form 4-ES

DECLARATION OF ESTIMATED TAX
(This Form To Be Filed At The Address Shown Above)

1965

Leave This Space Blank

File No. 99-40723

Corporation name Humble Oil & Refining Company

Corporation address 800 Bell Avenue, Houston, Texas 77002

This declaration is for: (Check one) ☒ Calendar year 1965 ☐ Fiscal year beginning ____ 19__ and ending ____ 19__

1.	1964 Wisconsin corporation income tax	$ None
2.	Estimate of 1965 Wisconsin corporation income tax	$ 2,500.00
3.	Deduct amount claimed for credit from overpayment of 1964 tax	$ 2,500.00
4.	Balance of estimated 1965 tax to be paid	$ None
5.	Computation of Payment: Check proper box and enter amount of payment	
	If this declaration is due to be filed on * (Fiscal Year Taxpayers, See Instructions)	☐ March 15, 1965, enter 1/4 of line 4 ☒ June 15, 1965, enter 1/3 of line 4 ☐ September 15, 1965, enter 1/2 of line 4 ☐ January 15, 1966, enter amount on line 4 $ None

I declare under the penalties of perjury that this declaration has been examined by me and to the best of my knowledge is a true, correct and complete declaration.

Signature B. F. Heidner Jr. Title Assistant Secretary Date May 18, 1965

WT-DC-845 *Overpayment of estimated tax for 1964 is applied as payment in full of estimated tax for 1965.

2987

A. 648

2988

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT

N. A. RANEAU
COORDINATOR
TAX COMPLIANCE

April 14, 1966

RECEIVED

APR 18 1966

WIS. DEPT. OF TAXATION
CORPORATION FRANCHISE
& INCOME TAX SECTION

Wisconsin Department of Taxation
Corporation Franchise and Income Tax Section
Post Office Box 98
Madison, Wisconsin 53701

Gentlemen:

Enclosed is the 1965 Wisconsin Corporation Franchise Tax Return for Humble Oil & Refining Company which reflects a loss of $821,320 from Wisconsin operations during the calendar year 1965.

Please credit the overpayment of declaration installments against our 1966 estimated tax. We have enclosed completed Form 4-ES, Declaration of Estimated Tax, so that this can be accomplished.

We appreciate very much your cooperation in granting us an extension of time until April 15, 1966 within which to file the final return.

Yours very truly,

R F Heidner Jr.

R. F. Heidner, Jr.

JWW/bc

Attachments

A. 649

2989

WT-IC-082.
Wisconsin Department of Taxation
Schedule J

Please refer to page [illegible] of
Instruction Booklet WT-IC-100

FORM 4A

BALANCE SHEETS OF Humble Oil & Refining Company
Name of Corporation

ASSETS	December 31, 1964 or other taxable year ending		December 31, 1965 or other taxable year ending	
1. Cash				
2. Notes and accounts receivable				
Less bad debt reserve				
3. Loans to stockholders				
4. Inventories				
Less inventory reserves				
5. Securities, stocks, bonds, etc.				
6. Other investments (attach schedule)				
7. Capital assets:				
Land				
Depreciable assets:				
Buildings				
Machinery				
Other equipment				
Furniture and fixtures				
Total depreciable assets				
Less depreciation reserves				
Depletable assets				
Less depletion reserve				
8. Intangible assets				
Less amortization reserve				
9. Goodwill		Schedule J-1		
10. Cash value of life insurance		Attached		
11. Other assets (attach schedule)				
Total assets				
LIABILITIES AND CAPITAL				
12. Accounts payable				
13. Notes payable				
14. Bonded and mortgage debt				
15. Real estate tax accruals				
16. Personal property tax accruals				
17. Payroll tax accruals				
18. Loans from stockholders				
19. Other accrued liabilities (attach schedule)				
20. Other liabilities (attach schedule)				
21. Surplus reserves:				
Wisconsin franchise and income tax				
U. S. income tax				
Other contingent (attach schedule)				
22. Capital stock:				
(a) Preferred stock				
(b) Common stock				
Total				
(c) Less treasury stock				
23. Capital surplus				
24. Earned surplus		(A)		(B)
Total liabilities and capital				

(A) and (B)—See lines 1 and 14, Schedule K

Schedule K — **ANALYSIS OF EARNED SURPLUS**

1. Balance at beginning of taxable year (must agree with item (A), line 24, Schedule J)		2,060,454,328
Amounts credited to earned surplus:		
2. Book income (see line 1, Schedule L)	462,435,949	
3. Other credits to earned surplus (itemize)		
4.		
5.		
6.		462,435,949
7.		2,522,890,277
Subtotal		
Amounts debited to earned surplus:		
8. Cash dividends (a) Preferred (date paid) 19	275,000,000	
(b) Common (date paid) 19		
9. Stock dividends (date paid) 19		
10. Other debits to earned surplus (itemize)		
11.		
12.		275,000,000
13.		2,247,890,277
14. Balance at end of taxable year (must agree with item (B), line 24, Schedule J)		

Schedule L — **RECONCILIATION OF BOOK INCOME WITH NET INCOME**

1. Book income (must agree with line 2, Schedule K)		
Add adjustments to arrive at net income:		
2. Premiums paid on corporate life insurance policies		
3. Unallowable contributions		
4. Non-deductible portion of U. S. income taxes paid (line 6, Schedule X)		
5. Athletic and social club dues		
6.		
7.		
8.		
9.		
10.		
11.		
12. Additions to surplus reserves charged against book income:		
(a) Wisconsin franchise and income tax		
(b) U. S. income tax		
(c)		
(d)		
(e)		
Subtotal		
Deduct adjustments to arrive at net income:		
13. Deductible dividends received (Schedule C)		
14. Non-taxable stock dividends received		
15. Net business loss offset (lines 25 and 26, page 1)		
16. Increase in cash value of life insurance		
17.		
18.		
19.		
20.		
21.		
22.		
23.		
24. Charges made on books against surplus reserves:		
(a) Wisconsin franchise and income tax		
(b) U. S. income tax		
(c)		
(d)		
(e)		
25. Net income (line 27, page 1, Form 4)		

Schedule O completed in lieu of Schedule L

2990

WT-IC-044
Wisconsin Department of Taxation

Form 4C

J

IMPORTANT – REFER TO ITEM ● OF INSTRUCTION BOOKLET WT-IC-100

Schedule N – 1965 SEPARATE ACCOUNTING DATA OF Humble Oil & Refining Company
Name of corporation

INCOME	1. Wisconsin	2. Outside	3. Total
Gross Operating Revenue	12,987,634	3,451,102,380	3,464,090,014
Cost of Goods Sold:			
Beginning Inventory	519,103	248,067,418	248,586,521
Purchases and Manufacturing Costs	8,823,042	2,555,315,924	2,564,138,966
Closing Inventory	355,913	259,882,017	260,237,930
Cost of Goods Sold	8,986,232	2,543,501,325	2,552,487,557
Gross Profit	4,001,402	907,601,055	911,602,457
Deduct:			
Marketing Expenses	5,312,198	361,235,966	366,548,164
Administrative Expenses	249,285	48,280,697	48,529,982
Total	5,561,483	409,516,663	415,078,146
Total income (Loss) From Operations	(1,560,081)	498,084,392	496,524,311

EXPENSES	Basis of Allocation			
Non-Operating Revenue:				
Royalties			176,892	176,892
Interest		13,411	2,248,892	2,262,303
Dividends			16,789,366	16,789,366
Rent Income		641,772	(641,772)*	
Other (Charges) and Credits				
Interest		(3,120)	(14,895,243)	(14,898,363)
Income Taxes			(37,345,514)	(37,345,514)
Other		(875)	(1,072,171)	(1,073,046)
Net Profit (Loss) Carried to Surplus		(908,893)	463,344,842	462,435,949

* The rental income of Humble Oil & Refining Company without Wisconsin has been netted against the Departmental Expenses. Since this is an item which can be clearly accounted for on a direct basis, we do not feel that it is necessary to go back and set out the "Outside Wisconsin" and the "Everywhere" amounts.

Total expenses			
Book income			

When Form 4C is used, Schedule O must be completed in place of Schedule L. The book income in column 3 must agree with line 2, Schedule K.

Schedule O RECONCILIATION OF BOOK INCOME WITH NET INCOME

	1. Wisconsin	2. Outside	3. Total
1. Book income (must agree with Schedule N) ..... (Loss)	(908,893)	463,344,842	462,435,949
Add adjustments to arrive at net income:			
2. Premiums paid on corporate life insurance policies			
3. Unallowable contributions	1,600		1,600
4. Non-deductible portion of U.S. income taxes paid (line 6, Schedule X)			
5. Athletic and social club dues			
6. Depreciation Not Deductible	99,384		99,384
7.			
8.			
9.			
10.			
11.			
12. Additions to surplus reserves charged against book income:			
(a) Wisconsin franchise and income tax			
(b) U.S. income tax			
(c)			
(d)			
(e)			
Subtotal	(807,909)	*	462,536,933
Deduct adjustments to arrive at net income:			
13. Deductible dividends received (Schedule C)			
14. Non-taxable stock dividends received			
15. Net business loss offset (lines 25 and 26, page 1)			
16. Increase in cash value of life insurance			
17. Interest Income Allocated to Residence of Recipient	13,411		13,411
18.			
19.			
20.			
21.			
22.			
23.			
24. Charges made on books against surplus reserves:			
(a) Wisconsin franchise and income tax			
(b) U.S. income tax			
(c)			
(d)			
(e)			
25. Net income (line 27, page 1) ..... (Loss)	(821,320)		
26. Net income (Outside and Total)		463,344,842	462,523,522

27. Were any products or supplies transferred between Wisconsin branches and branches outside Wisconsin? Yes ☒ No ☐

If yes, insert the approximate amount of transfers into Wisconsin $ Not available, at this time. and out of Wisconsin $ Not available at this time.

and attach explanation of how transfer prices were determined.

28. Explain bases used to allocate expenses on Schedule N. Expenses deducted are those actually incurred in Wisconsin with the exception of overhead which is allocated on the basis of sales.

* Detailed adjustments outside Wisconsin are not yet available and will not be until such time as the Federal return is completed. If such detail is required, please notify us and we will gladly furnish it at such time as the Federal return is completed.

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HUMBLE OIL & REFINING COMPANY
800 BELL AVENUE, HOUSTON, TEXAS 77002

1965 Wisconsin Corporation Franchise Tax Return

Schedule J-1 - Comparative Balance Sheet

	December 31, 1964	December 31, 1965
Assets		
Cash	$ 45,153,569	$ 39,912,063
Notes and Accounts Receivable	$ 583,469,132	
Reserve	12,241,498	
	465,893,914	571,227,634
Inventories	272,491,379	283,585,012
Investments		205,115,243
Reserve		12,248,523
	216,778,056	192,866,720
Fixed Assets	5,479,265,380	
Reserve	2,637,124,239	
	2,841,346,141	2,962,117,254
Contracts, Trademarks and Other Intangibles		7,387,445
Reserve		3,317,364
	4,245,972	4,070,081
Special Deposits and Funds		2,865,225
Reserve		4,410
	2,568,172	2,860,815
Prepaid and Deferred Charges	22,512,105	26,820,512
Total Assets	$3,870,989,308	$4,083,460,091
Liabilities and Capital		
Accounts Payable	$ 245,007,611	$ 238,141,709
Bonds, Notes and Mortgages Payable	25,434,531	20,407,147
Annuities Payable to Employees - Liabilities Determined by Actuarial Study (Including Temporary Early Retirement Allowance)	46,542,038	38,122,702
Accrued Expenses		84,622,896
Government Income Taxes	163,548,345	$ 136,605,410
Other Taxes, Interest, Insurance, Etc.	88,952,209	
Deferred Credits	18,988,595	
Other Liabilities	773,604,647	
Capital Stock (Common)	448,457,004	
Capital Surplus	2,060,454,328	2,247,890,277
Earned Surplus		
Total Liabilities and Capital	$3,870,989,308	$4,083,460,091

CHICAGO BY

2992

HUMBLE OIL & REFINING COMPANY
800 BELL AVENUE, HOUSTON, TEXAS 77002

1965 Wisconsin Corporation Franchise Tax Return

Exhibit I - Corporations of Which Taxpayer Owned
50 Per Cent or More of Voting Stock at December 31, 1965

Bonded Oil Company, Inc.
Carter Oil Company, The
Enjay, Inc.
Esso, Incorporated
Esso Production Research Company
Extrudo Film Corporation
Friendswood Development Company
Gaseteria Corporation
General Automatic Corporation
Humble Communications Company
Humble Gas Transmission Company
Humble Pipe Line Company
Humble Travel Club, Inc.
Monterey Oil, Gas & Transmission Company
National Plastic Products Company, Inc.
Oklahoma Oil Company
Pate Oil Company
Penola Oil, Inc.
Petroleum Casualty Company
Petroleum Heat and Power Company
Prince George Corporation, The
Red Bluff Development Company
Solar-Therm Corporation of America
Standard Oil Company, Inc.
Yolo County Sales Company

2993

HUMBLE OIL & REFINING COMPANY
WISCONSIN CORPORATION FRANCHISE TAX RETURN
FOR CALENDAR YEAR 1965

Schedule Z-1 - Districts from Which Income is Derived

NAME	TOWN	VILLAGE	CITY	COUNTY	PROPERTY	SALES
DePere			X	Brown	$ 29,882	$ 31,189
Green Bay			X	Brown	295,599	308,525
Columbus			X	Columbia	13,639	14,236
Madison			X	Dane	418,228	436,516
Deforest		X		Dane	32,734	34,166
Beaver Dam			X	Dodge	31,866	33,260
Watertown			X	Dodge	215,624	225,053
Sturgeon Bay			X	Door	23,683	24,718
Ripon			X	Fond du Lac	40,670	42,448
Waupon			X	Fond du Lac	56,169	58,625
Jefferson			X	Jefferson	1,240	1,294
Kenosha			X	Kenosha	149,536	156,074
Tomahawk			X	Lincoln	20,211	21,095
Manitowic			X	Manitowic	36,330	37,919
Two Rivers			X	Manitowic	22,691	23,683
Schofield			X	Marathon	30,130	31,448
Wausau			X	Marathon	64,352	67,166
Brookfield			X	Milwaukee	511,967	534,354
Cudahy			X	Milwaukee	32,114	33,518
Elm Grove		X		Milwaukee	113,578	118,544
Franklin			X	Milwaukee	133,788	139,639
Glendale			X	Milwaukee	46,993	49,048
Greendale			X	Milwaukee	123,001	128,379
Hales Corners		X		Milwaukee	217,236	226,735
Milwaukee			X	Milwaukee	6,914,572	7,256,495
Oak Creek			X	Milwaukee	88,283	92,143
So. Milwaukee			X	Milwaukee	159,579	166,557
Kimberly		X		Outagamie	31,742	33,130
Cederburg			X	Ozaukee	40,670	42,448
MeQuon			X	Ozaukee	85,431	89,167
Port Washington			X	Ozaukee	7,192	- 7,506
Thiensville		X		Ozaukee	63,856	66,649
Burlington			X	Racine	143,460	149,733
Racine			X	Racine	602,234	628,568
Sturtevant			X	Racine	75,388	78,684
Waterford			X	Racine	53,689	56,037
Elkhart Lake			X	Sheboygan	4,836	5,047
Sheboygan			X	Sheboygan	100,186	104,567
Delavan			X	Walworth	24,303	25,365
Elkhorn		X		Walworth	50,961	53,190
Lake Geneva			X	Walworth	35,462	37,013
Germantown	X			Washington	20,583	21,483
West Bend			X	Washington	49,597	51,766
Butler		X		Waukesha	75,016	78,296

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Page 2

NAME	TOWN	VILLAGE	CITY	COUNTY	PROPERTY	SALES
Lannon		X		Waukesha	40,794	42,578
Menomonee Falls		X		Waukesha	219,220	228,806
New Berlin			X	Waukesha	127,093	132,650
Oconomowoc			X	Waukesha	60,261	62,896
Okauchee	X			Waukesha	22,443	23,424
Pewaukee		X		Waukesha	44,389	46,331
Waukesha			X	Waukesha	317,050	330,914
Kiel			X	Winnebago	20,333	21,224
Menasha			X	Winnebago	29,386	30,671
Oshkosh			X	Winnebago	76,008	79,331
Wisconsin Rapids	X			Wood	39,802	41,542
Edgerton			X	Rock	37,446	39,083
Janesville			X	Rock	83,073	86,708
GRAND TOTAL					12,405,601	12,987,634

CHICAGO BY COMPARISON

WT-IC-090

2995

FORM 9X

File No. 99-40723

MAR 17 1966

WIS. DEPT. OF TAXATION CORPORATION FRANCHISE & INCOME TAX SECTION

1965
WISCONSIN
Corporation Annual Information Return

SUMMARY OF REPORTS OF SALARY, WAGE, INTEREST, DIVIDEND AND RENT PAYMENTS AND TRANSFERS OF CAPITAL STOCK

FOR THE CALENDAR YEAR 1965

Name	State of Incorporation
Humble Oil & Refining Company	Delaware
Mailing Address (Street and Number)	**City** / **State** / **Zip Code**
P. O. Box 2180 — Houston — Texas — 77001	

Indicate in the spaces below the total number of Forms 8 and 9b submitted:

	Filed with this report	Previously filed
FORMS 8	--	--
FORMS 9b	✓79	--

Have Forms WT-7 and WT-9 been submitted to The Wisconsin Department of Taxation, Post Office Box 34, Madison, Wisconsin, 53701 in accordance with the Provisions of Sections 71.10(8m), 71.10(8n), and 71.20(4) of The Wisconsin Statutes?

Check one: YES ☒ NO ☐

If the above answer is yes, state the total number of Forms WT-9 Filed (From line 1, Form WT-7)	973
State the amount of Wisconsin income tax withheld as shown on all Forms WT-9 Filed (From line 2, Form WT-7)	$ 42,486.68
Insert your Wisconsin employer identification number	32803

INSTRUCTIONS

Form 9X must be filed by all corporations regardless of whether it is necessary to file Forms 8 and 9b. The 1965 Form 9X is due by March 15, 1966. Forms 8 for 1965 are due by March 15, 1966. Forms 9b for 1965 are due either January 31, 1966 or March 15, 1966, according to the instructions on the back of the Form 9b.

Forms 8, 9b and 9X must be prepared on the basis of the calendar year even though your franchise tax return is filed on a fiscal year basis.

Only one Form 9X is required even though you may have a main office and one or more branch offices. Further instructions regarding the preparation and filing of Forms 8 and 9b are on the back of those forms.

I declare to the best of my knowledge and belief the Forms 8 submitted constitute a report of all stock transfers from Wisconsin residents, and the Forms 9b submitted constitute a true and complete statement of payments made and required to be reported by the corporation named at the head of this statement during the calendar year 1965.

D. A. Ranger — (Signature)

TAX COMPLIANCE COORDINATOR — (Title of office held)

Date March 14, 1966

Mail Forms 8, and 9b with Form 9X to

WISCONSIN DEPARTMENT OF TAXATION
CORPORATION FRANCHISE AND INCOME TAX SECTION
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

WT-1C-050 RECEIVED
MAR 5 1966
WIS. DEPT. OF TAXATION
CORPORATION FRANCHISE
& INCOME TAX SECTION

2996

FORM 9X

1965
WISCONSIN
Corporation Annual Information Return

File No.....

SUMMARY OF REPORTS OF SALARY, WAGE, INTEREST, DIVIDEND AND RENT PAYMENTS AND TRANSFERS OF CAPITAL STOCK
FOR THE CALENDAR YEAR 1965

Name	State of Incorporation
HUMBLE OIL & REFINING COMPANY	Delaware

Mailing Address — Street and Number	City	State	Zip Code
P.O. BOX 801	TULSA	OKLAHOMA	74102

Indicate in the spaces below the total number of Forms 8 and 9b submitted:

	Filed with this report	Previously filed
FORMS 8		
FORMS 9b	86 ✓	

Have Forms WT-7 and WT-9 been submitted to The Wisconsin Department of Taxation, Post Office Box 34, Madison, Wisconsin, 53701 in accordance with the Provisions of Sections 71.10(8m), 71.10(8n), and 71.20(4) of The Wisconsin Statutes?

Check one: YES ☒ NO ☐

If the above answer is yes, state the total number of Forms WT-9 Filed (From line 1, Form WT-7)	891
State the amount of Wisconsin income tax withheld as shown on all Forms WT-9 Filed (From line 2, Form WT-7)	36,729.05
Insert your Wisconsin employer identification number	32803

INSTRUCTIONS

Form 9X must be filed by all corporations regardless of whether it is necessary to file Forms 8 and 9b. The 1965 Form 9X is due by March 15, 1966. Forms 8 for 1965 are due by March 15, 1966. Forms 9b for 1965 are due either January 31, 1966 or March 15, 1966, according to the instructions on the back of the Form 9b.

Forms 8, 9b and 9X must be prepared on the basis of the calendar year even though your franchise or income tax return is filed on a fiscal year basis.

Only one Form 9X is required even though you may have a main office and one or more branch offices. Further instructions regarding the preparation and filing of Forms 8 and 9b are on the back of those forms.

I declare to the best of my knowledge and belief the Forms 8 submitted constitute a report of all stock transfers from Wisconsin residents, and the Forms 9b submitted constitute a true and complete statement of payments made and required to be reported by the corporation named at the head of this statement during the calendar year 1965.

x R.D. Mamaluca RDM — Assistant Treasurer
(Signature) (Title of office held)

Date March 4, 1966

Mail Forms 8, and 9b with Form 9X to

WISCONSIN DEPARTMENT OF TAXATION
CORPORATION FRANCHISE AND INCOME TAX SECTION
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

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Schedule E — COMPENSATION OF OFFICERS (See Instruction 8)

Name	Residence if Other State?	Official Title	Per cent of Corporation Stock Owned: Common	Per cent of Corporation Stock Owned: Preferred	Amount of Compensation
Total to line 8, page 1					None

Schedule F — DEPRECIATION (See Instruction 12)

Character of Property	Rate (%) or Life	Amount of Depreciation: 1965	Amount of Depreciation: Accumulated Depreciation Allowed in Prior Years	Analysis of Asset Account: Balance Beginning of Year	Analysis of Asset Account: Additions During Year	Analysis of Asset Account: Assets Written Off During Year	Analysis of Asset Account: Balance End of Year
			← Total additional first-year depreciation (do not include in items below)				
			Schedules supporting deductions are voluminous but are available for inspection.				
Total to line 12, page 1							
Totals							

Schedule G — OTHER LOSSES* (See Instruction 14)

Kind of Loss	Amount
Bad Debts Charged Off	90,734
Total to line 14, page 1	90,734

* Savings and Loan Associations, Mutual Savings Banks and Credit Unions, see Instruction 14

Schedule H — TAXES (See Instruction 15)

Kind of Tax	Date Paid: Month	Date Paid: Year	Amount
1. Real estate			266,576
2. Personal property			
3. Wisconsin franchise and/or income			
Federal and State			39,784
Employers Taxes			16,405
Permits and Licenses			16,100
Other			
Total to line 15, page 1			338,865

1. Location of books and records for audit purposes: 800 Bell Avenue (Street and Number), Houston, (City), Texas (State)

2. Method of filing — see General Instruction D: Cash ☐ Accrual ☒

3. (a) Attach list of corporations in which you own, directly or indirectly, 50% or more of the outstanding voting stock. Exhibit I Attached

(b) Have the incomes of these affiliated corporations been included in this return? Yes ☐ No ☒

4. (a) Give the names of any corporations, individuals, partnerships, trusts or associations which own 50% or more of your outstanding voting stock: Standard Oil Company (New Jersey), 100%.

(b) Have the incomes of any of these organizations been included in this return? Yes ☐ No ☒

5. Did you sell to, or buy from, any individual or organization listed in items 3 or 4 above? Yes ☒ No ☐ If yes, insert approximate amount of such sales: Not available at this time. purchases: Not available at this time. and attach explanations of how transfer prices were determined.

6. If your corporation has been involved in any reorganization during the period covered by this return, attach a detailed explanation.

7. Insert your Wisconsin withholding tax employer's identification number: 32803 (If none, write none)

8. Insert your Wisconsin seller's permit number: 39561 - Various (If none, write none), or use tax number: 39561 (If none, write none)

Page 4

Schedule I — OTHER ORDINARY AND NECESSARY EXPENSES

End of Income	Amount Dollars
Travel, Trade and Touring	69,559
Commissions Paid Consignment	353,106
Painting	40,453
Installation and Removal	21,423
Credit and Collection	58,242
Sales Promotion	65,468
Products Consumed	18,821
Postage, Stationery & Supplies	57,376
Outside Transportation	113,185
Fuel Light and Power	37,310
Telephone and Telegraph	32,477
Outside Services	24,651
Administrative Expense	249,285
Area Expense - Marketing	181,910
- Accounting	271,391
- Other	125,988
Misc. Marketing Expense	13,967
Other Miscellaneous Expense	1,296
Casualty Losses	11,960
Advertising	534,102
Total to line 18, page 1	2,269,970

Schedule X — U.S. INCOME TAXES

1. Paid in 1965 on 1964 income	
2. Paid in 1965 on 1965 income	
3. Additional assessments paid in 1965 on incomes of prior years	
4. Total	
5. Amount deductible (limited to 10% of line 20, page 1 — to line 21, page 1)	
6. Non-deductible portion (line 4 minus line 5 — to line 4, Schedule L)	None

Schedule Y — CONTRIBUTIONS

Name	State	Amount
Contributions carry over		
Total to line 23, page 1		None

CHECKED BY COMPTOMETER

Schedule Z — DISTRICTS FROM WHICH INCOME IS DERIVED

THIS SCHEDULE MUST BE COMPLETED BY ALL CORPORATIONS WHICH DERIVE THEIR INCOME FROM MORE THAN ONE MUNICIPALITY

Enter the legal name of each municipality, checking the proper city, village or town block, and the name of the appropriate county in which a portion of your income was derived. If your operation in each of the various municipalities listed was an integral part of a unitary business, the amount of property (net value, but include inventory), cost of manufacturing, and sales attributable to each municipality must be inserted in the proper column. If any factor for a particular municipality is zero, insert "none" in the column.

If the operation in each of the various municipalities listed was not an integral part of a unitary business, and if the net profit in each location can be separately determined in accordance with Section 71.07, such net profit figure for each municipality may be submitted in the last column in lieu of the data required in the preceding three columns.

DISTRICT Name	Check one: City	Vil.	Town	County	AMOUNT Property	Cost of Manufacturing	Sales	Net Profit
					Schedule Z-1 Attached			
Totals								

1/M

DECLARATION

We, the undersigned, president (or vice-president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, each for himself declares that this return (including any accompanying schedules and statements) has been personally examined by him and is, to the best of his knowledge and belief, a true and correct report of income under the provisions of Chapter 71 of the Wisconsin Statutes.

	Vice-President	April 15, 1966
Signature	Title	Date
	Treasurer	April 15, 1966
Signature	Title	Date
Individual or firm signature of preparer	Address	Date

EXHIBIT 11-7B

2998 Ex 7B HC

WISCONSIN CORPORATION FRANCHISE OR INCOME TAX RETURN

FOR RAISING STATE, COUNTY AND MUNICIPAL REVENUES

FORM 4

Ex 11-7B HC

Due the 15th day of the third month following the close of the income year. Mail to: WISCONSIN DEPARTMENT OF TAXATION, Corporation Franchise or Income Tax Section, Post Office Box 59, Madison, Wisconsin

APR 18 1967

1966 or other income year: Beginning 10-2-74 Ending

DEPT. OF TAXATION CORPORATION FRANCHISE OR INCOME TAX SECTION

LEAVE BLANK File No. 72 20725 Type CA Form 4-65 LES Late Fee ☐ Inv. Rpt. Fee ☐

A. Name: Humble Oil & Refining Company

B. Mailing Address: 800 Bell Avenue — Street and Number; Houston — City; Texas — State; C. Zip Code: 77002

D. State of Incorporation: Delaware — E. Year of Incorporation: 1959 — F. Principal Business Activity: All phases of the petroleum industry — G. Principal Product or Service: Petroleum and Its Products — H. Bus. Code No.: 1310

I. If all your income is derived from within one municipality, complete blocks J and K. If your income is derived from more than one municipality, complete Schedule Z, page 4. — J. City ☐ Village ☐ or Town ☐ of — K. County of — Leave Blank: CMH-7-13

IMPORTANT — PLEASE REFER TO INSTRUCTION BOOKLET WT-IC-100

INCOME	1. Gross receipts or gross sales, less returns and allowances	14,050,904
	2. Cost of goods sold (Schedule A) or cost of operations (attach schedule)	9,228,443
	3. Gross profit	4,822,461
	4. Profits (losses) from disposal of capital assets (Schedule B) (Loss) FIELD AUDITED	(61,620)
	5. Gross dividends (Schedule C)	-
	6. All other income (Schedule D)	638,290
	7. Total income from all sources	5,399,131
DEDUCTIONS	8. Compensation of officers (Schedule E)	-
	9. Wages and bonuses	1,715,258
	10. Repairs	398,500
	11. Rent	587,546
	12. Depreciation (Schedule F)	537,831
	13. Depletion and amortization (attach schedule)	26,830
	14. Other taxes (Schedule G)	275,390
	15. Taxes (Schedule H)	404,680
	16. Deductible dividends received (Schedule C)	-
	17. Interest	2,818
	18. Other ordinary and necessary expenses (Schedule I)	2,610,108
	19. Total (lines 8 through 18)	6,558,951
	20. Subtotal (line 7 minus line 19) (Loss)	(1,159,830)
	21. U.S. income taxes (not in excess of 10% of line 20) (Schedule X)	-
	22. Subtotal (Loss)	(1,159,830)
	23. Contributions (not in excess of 5% of line 22) (attach schedule)	-
	24. Subtotal (Loss)	(1,159,830)
	25. Unused 1964 net business loss offset	-
	26. 1965 net business loss offset	-
	27. Net income (Loss)	(1,159,830)

CHECKED BY COMPTOMETER

TO BE COMPLETED ONLY BY CORPORATIONS REPORTING ON THE APPORTIONMENT METHOD (Form 4B)

Leave Blank

APPORTIONMENT	28. Total company net non-apportionable income (loss)—item (T), line 13, Form 4B		
	29. Apportionable income (line 27 minus line 28)		
	30. Per cent to Wisconsin (line 27, Form 4B)	%	
	31. Amount to Wisconsin		
	32. Wisconsin net non-apportionable income (loss)—item (W), line 13, Form 4B		
	33. Wisconsin net income		
	34. Wisconsin sales		0 1 2 3 4 5 6 7

	Compute either the franchise or income tax, not both	Franchise Tax	Income Tax	Leave Blank
TAX	35. Total tax (see instruction F)	None	None	
	36. Less: Declaration installments paid (Form 4-ES)	2,500		
	37. Other payments and credits			
	38. Balance due — attach remittance	2,500		
	39. Overpayment — complete line 40			
	40. Enter amount of overpayment you want credited on 1967 estimated tax	$ 2,500	41. Refunded	$

WT3 3427 APR 18 67 CO 8

Page 2

Schedule A — COST OF GOODS SOLD (See Instruction 2)

1. Inventory at begining of year (complete lines 9 and 10)	355,818
2. Merchandise purchased for manufacturing	-
3. Merchandise purchased for resale	9,211,451
4. Salaries and wages	-
5. Cost of manufacturing (submit schedule)	-
6. Total	9,567,269
7. Inventory at end of year	338,826
8. Cost of goods sold to line 2, page 1	9,228,443

9. Have you included Form 10? Yes ☐ No ☐ See General Instructions K-4.
10. Has your method of inventory valuation changed? Yes ☐ No ☒ If yes, attach explanation.

Schedule B — PROFITS (LOSSES) FROM DISPOSAL OF CAPITAL ASSETS (See Instruction 4)

Kind of Property	Sites Wis.	Sites Outside	Cost or Other Basis	Depreciation Allowed or Allowable	Net Tax Cost	Gross Sales Price less Expense of Sale	Profit (Loss)
Detailed records are maintained by taxpayer and are available for inspection.							
Total to line 4, page 1							

Schedule C — DIVIDENDS (See Instruction 5)

Name of Declaring Corporation	Gross Dividends	Deductible Dividend Received
Gross dividend income to line 8, page 1	None	
Deductible dividends received to line 16, page 1		None

Schedule D — ALL OTHER INCOME (See Instruction 6)

1. Interest from securities (except amounts required on line 2)	
2. Interest from obligations of the United States and its instrumentalities*	
3. All other interest	584,079
4. Rent	
5. Royalties from tangible property	
6. Royalties from patents and intangible property	
7. Collections of accounts written off in previous years	
8. Tax refunds	
State Gasoline Tax Allowance	52,484
Other Income	1,727
Total to line 6, page 1	638,290

*Interest from obligations of the United States and its instrumentalities is not taxable income for corporations subject to income tax. See introduction to instruction booklet.

WT-IC-642
Wisconsin Department of Taxation
Schedule J

Please refer to page 5 of Instruction Booklet WT-IC-100

2999 FORM 4A

BALANCE SHEETS OF Humble Oil & Refining Company
Name of Corporation

ASSETS	December 31, 1966 or other income year ending		December 31, 1966 or other income year ending	
1. Cash				
2. Notes and accounts receivable				
Less bad debt reserve				
3. Loans to stockholders				
4. Inventories				
Less inventory reserves				
5. Securities, stocks, bonds, etc.				
6. Other investments (attach schedule)				
7. Capital assets:				
Land				
Depreciable assets:				
Buildings				
Machinery				
Other equipment				
Furniture and fixtures				
Total depreciable assets				
Less depreciation reserves		Schedule J-1 Attached		
Depletable assets				
Less depletion reserve				
8. Intangible assets				
Less amortization reserve				
9. Goodwill				
10. Cash value of life insurance				
11. Other assets (attach schedule)				
Total assets				
LIABILITIES AND CAPITAL				
12. Accounts payable				
13. Notes payable				
14. Bonded and mortgage debt				
15. Real estate tax accruals				
16. Personal property tax accruals				
17. Payroll tax accruals				
18. Loans from stockholders				
19. Other accrued liabilities (attach schedule)				
20. Other liabilities (attach schedule)				
21. Surplus reserves:				
Wisconsin franchise and income tax				
U. S. income tax				
Other contingent (attach schedule)				
22. Capital stock:				
(a) Preferred stock				
(b) Common stock				
Total				
(c) Less treasury stock				
23. Capital surplus				
24. Earned surplus	(A)		(B)	
Total liabilities and capital				

(A) and (B)—See lines 1 and 14, Schedule K

Schedule K — ANALYSIS OF EARNED SURPLUS

1. Balance at beginning of income year (must agree with item (A), line 24, Schedule J)		2,247,890,277
Amounts credited to earned surplus:		
2. Book income (see line 1, Schedule L)	535,140,618	
3. Other credits to earned surplus (itemize)		
4.		
5.		
6.		535,140,618
7. Subtotal		2,783,030,895
Amounts debited to earned surplus:		
8. Cash dividends (a) Preferred ..... (date paid ..... 19..)		
(b) Common ..... (date paid ..... 19..)	325,000,000	
9. Stock dividends ..... (date paid ..... 19..)		
10. Other debits to earned surplus (itemize)		
11.		
12.		325,000,000
13.		
14. Balance at end of income year (must agree with item (B), line 24, Schedule J)		2,458,030,895

Schedule L — RECONCILIATION OF BOOK INCOME WITH NET INCOME

1. Book income (must agree with line 2, Schedule K)		
Add adjustments to arrive at net income:		
2. Premiums paid on corporate life insurance policies		
3. Unallowable contributions		
4. Non-deductible portion of U. S. income taxes paid (line 6, Schedule X)		
5. Athletic and social club dues		
6.		
7.		
8.		
9.		
10.		
11.		
12. Additions to surplus reserves charged against book income:		
(a) Wisconsin franchise and income tax		
(b) U. S. income tax		
(c)		
(d)		
(e)		
Subtotal		
Deduct adjustments to arrive at net income:		
13. Deductible dividends received (Schedule C)		
14. Non-taxable stock dividends received		
15. Net business loss offset (lines 25 and 26, page 1)		
16. Increase in cash value of life insurance		
17.		
18.		
19.		
20.		
21.		
22.		
23.		
24. Charges made on books against surplus reserves:		
(a) Wisconsin franchise and income tax		
(b) U. S. income tax		
(c)		
(d)		
(e)		
25. Net income (line 27, page 1, Form 4)		

Schedule O Completed in Lieu of Schedule L

3000

HUMBLE OIL & REFINING COMPANY
800 BELL AVENUE, HOUSTON, TEXAS 77002

1966 Wisconsin Corporation Franchise Tax Return

Schedule J-1 - Comparative Balance Sheet

	December 31, 1965	December 31, 1966
Assets		
Cash	$ 39,912,063	$ 45,817,001
Notes and Accounts Receivable	571,227,634	$ 554,899,467
Reserve	283,585,012	11,912,948
		542,986,519
Inventories	192,866,720	249,253,431
Investments		215,538,217
Reserve		7,362,000
		208,176,217
Fixed Assets	2,962,117,254	5,467,970,807
Reserve		2,474,556,422
		2,993,414,185
Contracts, Trademarks and Other Intangibles	4,070,061	7,724,849
Reserve		3,920,161
		3,804,688
Special Deposits and Funds	2,860,815	4,926,829
Reserve		4,410
		4,922,219
Prepaid and Deferred Charges	26,820,512	28,543,169
Total Assets	$4,083,460,091	$4,076,917,429
Liabilities and Capital		
Accounts Payable	$ 238,141,709	$ 245,851,163
Bonds, Notes and Mortgages Payable	20,407,147	33,801,168
Annuities Payable to Employees - Liabilities Determined by Actuarial Study (Including Temporary Early Retirement Allowance)	38,122,702	32,623,634
Accrued Expenses		$ 87,531,243
Government Income Taxes	221,228,306	124,823,026
Other Taxes, Interest, Insurance, Etc.	79,401,975	212,354,269
Deferred Credits	16,206,324	73,615,811
Other Liabilities	773,604,647	17,869,523
Capital Stock (Common)	448,457,004	773,604,647
Capital Surplus	2,247,890,277	229,164,883
Earned Surplus		2,458,032,331
Total Liabilities and Capital	$4,083,460,091	$4,076,917,429

CHICAGO BY COMPARISON

3001

WT-IC-044
Wisconsin Department of Taxation

Form 4C

IMPORTANT – REFER TO GENERAL INSTRUCTION J OF INSTRUCTION BOOKLET WT-IC-100

Schedule N – 1966 SEPARATE ACCOUNTING DATA OF ..... (Name of corporation)

INCOME	1. Wisconsin	2. Outside	3. Total
Gross Operating Revenue	14,050,904	3,338,526,204	3,352,579,108
Cost of Goods Sold:			
Beginning Inventory	355,818	259,882,112	260,237,930
Purchases & Manufacturing Costs	9,211,451	2,324,672,514	2,333,883,965
Closing Inventory	338,826	228,429,963	228,768,789
Cost of Goods Sold	9,228,443	2,356,124,663	2,365,353,106
Gross Profit	4,822,461	982,403,541	987,226,002
Deduct:			
Marketing Expense	6,523,630	354,601,194	361,124,824
Administrative Expense	120,137	38,142,981	38,263,118
Total	6,643,767	392,744,175	399,387,942
Total income (Loss) From Operations	(1,821,306)	589,659,366	587,838,060

EXPENSES	Basis of Allocation			
Non-Operating Revenue:				
Royalties			235,439	235,439
Interest		37,868	2,084,870	2,122,738
Dividends			20,255,740	20,255,740
Rent Income		584,079	(584,079)*	
Other (Charges) & Credits:				
Interest		(2,818)	(10,208,409)	(10,211,227)
Income Taxes			(62,451,181)	(62,451,181)
Other		(7,409)	(2,641,542)	(2,648,951)
Net Profit (Loss) Carried to Surplus		(1,209,586)	536,350,204	535,140,618
Total expenses				
Book income				

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* The rental income of Humble Oil & Refining Company without Wisconsin has been netted against the Departmental Expenses. Since this is a item which can be clearly accounted for on a direct basis, we do not feel that it is necessary to go back and set out the "Outside Wisconsin" and the "Everywhere" amounts.

When Form 4C is used, Schedule O must be completed in place of Schedule L. The book income in column 3 must agree with line 2, Schedule K.

(over)

Schedule O RECONCILIATION OF BOOK INCOME WITH NET INCOME

	1. Wisconsin	2. Outside	3. Total
1. Book income (must agree with Schedule N) ..... (Loss)	(1,209,586)	536,350,204	535,140,618
Add adjustments to arrive at net income:			
2. Premiums paid on corporate life insurance policies			
3. Unallowable contributions	1,400		1,400
4. Non-deductible portion of U.S. income taxes paid (line 6, Schedule X)			
5. Athletic and social club dues			
6. Depreciation Not Deductible	86,224		86,224
7.			
8.			
9.			
10.			
11.			
12. Additions to surplus reserves charged against book income:			
(a) Wisconsin franchise and income tax			
(b) U.S. income tax			
(c)			
(d)			
(e)			
Subtotal	(1,121,962)	*	535,228,242
Deduct adjustments to arrive at net income:			
13. Deductible dividends received (Schedule C)			
14. Non-taxable stock dividends received			
15. Net business loss offset (lines 25 and 26, page 1)			
16. Increase in cash value of life insurance			
17. Interest Income Allocated to Residence of Recipient	37,868		37,868
18.			
19.			
20.			
21.			
22.			
23.			
24. Charges made on books against surplus reserves:			
(a) Wisconsin franchise and income tax			
(b) U.S. income tax			
(c)			
(d)			
(e)			
Subtotal	37,868		37,868
25. Net income (line 27, page 1)	(1,159,830)		
26. Net income (Outside and Total)		536,350,204	535,190,374

CHECKED BY

27. Were any products or supplies transferred between Wisconsin branches and branches outside Wisconsin? Yes ☒ No ☐

If yes, insert the approximate amount of transfers into Wisconsin $ Not available at this time. and out of Wisconsin $ Not available at this time.

and attach explanation of how transfer prices were determined.

28. Explain bases used to allocate expenses within and without Wisconsin Expenses deducted are those actually incurred in Wisconsin with the exception of overhead which is allocated on the basis of sales.

* Detailed adjustments outside Wisconsin are not yet available and will not be until such time as the Federal return is completed. If such detail is required, please notify us and we will

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HUMBLE OIL & REFINING COMPANY
800 BELL AVENUE, HOUSTON, TEXAS 77002

1966 Wisconsin Corporate Franchise Tax Return
Exhibit I

A. Corporations of Which Taxpayer Owned Over 50 Per Cent of Voting Stock at December 31, 1966:

Name	Address	Per-centage Owned	Date Acquired
Arven, Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1966
Bonded Oil Company, Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Carter Oil Company, The	800 Bell Avenue, Houston, Texas 77002	100.00	1959
Esso, Incorporated	60 West 49th Street, New York, New York 10020	100.00	1959
Esso Production Research Company	3120 Buffalo Speedway, Houston, Texas 77006	100.00	1964
Freeway Service Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1966
Friendswood Development Company	800 Bell Avenue, Houston, Texas 77002	100.00	1962
Gasteria Corporation	800 Bell Avenue, Houston, Texas 77002	100.00	1960
General Automatic, Inc.	900 First Nat'l Bank Bldg., Baltimore, Maryland 21203	100.00*	1960
Humble Communications Company	800 Bell Avenue, Houston, Texas 77002	100.00	1961
Humble Gas Transmission Company	1700 Commerce Bldg., New Orleans, Louisiana 70112	100.00	1962
Humble Leasing Company	800 Bell Avenue, Houston, Texas 77002	100.00	1966
Humble Pipe Line Company	800 Bell Avenue, Houston, Texas 77002	100.00	1961
Humble Travel Club, Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1964
Link Company	800 Bell Avenue, Houston, Texas 77002	100.00	1966
Monterey Oil, Gas & Transmission Co.	821 Gravier Street, New Orleans, Louisiana 70160	100.00	1961
Oklahoma Oil Company	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Pate Oil Company	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Penola Oil, Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Petroleum Casualty Company	800 Bell Avenue, Houston, Texas 77002	100.00	1964
Petroleum Heat and Power Company	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Prince George Fuel Corporation, The	900 First Nat'l Bank Bldg., Baltimore, Maryland 21203	100.00*	1962
Red Bluff Development Company	800 Bell Avenue, Houston, Texas 77002	100.00	1965
Solar-Therm Corporation of America	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Standard Oil Company, Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1960

*No Stock Issued

B. Corporation Owning 50 Per Cent or More of Taxpayer's Voting Stock:

Name	Address	Per-centage Owned	Date Acquired
Standard Oil Company (New Jersey)	30 Rockefeller Plaza, New York, New York 10020	100.00	1959

~~1966~~ -

3003

HUMBLE OIL & REFINING COMPANY
WISCONSIN CORPORATION FRANCHISE TAX RETURN
FOR CALENDAR YEAR 1966

Schedule Z-1 - Districts from Which Income is Derived

NAME	TOWN	VILLAGE	CITY	COUNTY	PROPERTY	SALES
DePere			X	Brown	$ 38,017	$ 29,593
Green Bay			X	Brown	315,039	361,994
Columbus			X	Columbia	17,838	13,886
Madison			X	Dane	428,189	527,914
DeForest		X		Dane	100,359	78,121
Beaver Dam			X	Dodge	38,738	30,155
Watertown			X	Dodge	222,654	231,699
Sturgeon Bay			X	Door	27,027	21,038
Ripon			X	Fond du Lac	50,089	38,990
Waupun			X	Fond du Lac	58,738	45,723
New Berlin			X	Green	158,916	154,840
Kenosha			X	Kenosha	158,916	154,840
Tomahawk			X	Lincoln	28,828	22,441
Manitowoc			X	Manitowoc	62,522	48,668
Two Rivers			X	Manitowoc	32,432	25,246
Schofield			X	Marathon	40,720	31,697
Wausau			X	Marathon	72,792	56,662
Milwaukee			X	Milwaukee	6,943,990	7,193,205
Fox Point			X	Milwaukee	131,710	102,525
Glendale			X	Milwaukee	76,395	59,467
Brookfield			X	Milwaukee	525,127	447,689
West Allis			X	Milwaukee	181,259	141,095
Oak Creek			X	Milwaukee	173,781	174,195
South Milwaukee			X	Milwaukee	167,430	149,791
Hales Corner		X		Milwaukee	229,725	256,664
Brown Deer		X		Milwaukee	15,856	12,342
Greendale			X	Milwaukee	138,376	107,715
Kimberly		X		Outagamie	40,720	31,697
Appleton			X	Outagamie	33,153	25,807
Little Chute	X			Outagamie	45,225	35,204
Bayside		X		Ozaukee	57,477	44,741
Thiensville		X		Ozaukee	94,413	73,493
Mequon			X	Ozaukee	116,034	90,323
Port Washington			X	Ozaukee	107,746	83,872
Cedarburg			X	Ozaukee	58,738	45,723
Saukville	X			Ozaukee	34,954	27,209
Belgium		X		Ozaukee	1,982	1,543
Burlington			X	Racine	145,493	152,175
Sturtevant			X	Racine	101,080	78,682
Racine			X	Racine	614,944	634,367
Waterford			X	Racine	65,585	51,052
Janesville			X	Rock	48,468	37,728
Edgerton			X	Rock	57,116	44,461

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Schedule Z-1 - Districts from Which Income is Derived

NAME	TOWN	VILLAGE	CITY	COUNTY	PROPERTY	SALES
Beloit			X	Rock	$ 94,954	$ 73,914
South Beloit	X			Rock	49,549	38,571
Afton		X		Rock	35,855	27,910
Orfordville	X			Rock	24,324	18,934
Franklin			X	Sheboygan	194,276	170,689
Sheboygan Falls			X	Sheboygan	5,225	4,067
Elkhart Lake			X	Sheboygan	3,964	3,086
Sheboygan			X	Sheboygan	118,871	150,913
Lake Geneva			X	Walworth	36,396	28,332
Delavan			X	Walworth	58,558	45,582
Elkhorn		X		Walworth	72,792	56,662
Whitewater			X	Walworth	66,485	51,753
Germantown	X			Washington	60,900	47,407
West Bend			X	Washington	65,585	51,052
Richfield	X			Washington	2,703	2,104
Menomonee Falls		X		Waukesha	243,509	228,473
Lannon		X		Waukesha	57,296	44,601
Butler		X		Waukesha	114,953	89,482
Wauwatosa			X	Waukesha	148,871	135,345
Elm Grove		X		Waukesha	139,998	108,977
Delafield			X	Waukesha	84,503	65,779
Pensaukee		X		Waukesha	75,675	58,906
Oconomowoc			X	Waukesha	55,314	43,058
Waukesha			X	Waukesha	324,499	330,437
Okauchee	X			Waukesha	28,108	21,879
Muskego	X			Waukesha	31,531	24,544
Oshkosh			X	Winnebago	75,494	58,766
Neenah			X	Winnebago	33,513	26,087
Menasha			X	Winnebago	23,603	18,373
Kiel			X	Winnebago	31,172	24,264
Wisconsin Rapids	X			Wood	31,712	24,685
	GRAND TOTAL				$14,448,779	$14,050,904

CHECKED BY

WT-IC-090 RECEIVED MAR 10 1967 W. DEPT. OF TAXATION CORPORATION FRANCHISE & INCOME TAX SECTION

3005

FORM 9X

File No. 99-40123

1966 WISCONSIN Corporation Annual Information Return

OF REPORTS OF SALARY, WAGE, INTEREST, DIVIDEND AND RENT PAYMENTS AND TRANSFERS OF CAPITAL STOCK

FOR THE CALENDAR YEAR 1966

Name	State of Incorporation
Humble Oil & Refining Company, Attention Sam Farrell	Delaware
Mailing Address Street and Number: P. O. Box 2180, Houston, Texas — City — State	Zip Code: 77001

Indicate in the spaces below the total number of Forms 8 and 9b submitted:

	Filed with this report	Previously filed
FORMS 8	--	--
FORMS 9b	211	--

	Check one	
Have Forms WT-7 and WT-9 been submitted to The Wisconsin Department of Taxation, Post Office Box 34, Madison, Wisconsin 53701 in accordance with the Provisions of Sections 71.10(8m), 71.10(8n), and 71.20(4) of The Wisconsin Statutes?	YES	☒
	NO	☐

If the above answer is yes, state the total number of Forms WT-9 filed (From line 1, Form WT-7)	1,498
State the amount of Wisconsin income tax withheld as shown on all Forms WT-9 filed (From line 2, Form WT-7)	$60,852.58
Insert your Wisconsin employer identification number	32803

INSTRUCTIONS

Form 9X must be filed by all corporations regardless of whether it is necessary to file Forms 8 and 9b. The 1966 Form 9X is due by March 15, 1967. Forms 8 for 1966 are due by March 15, 1967. Forms 9b for 1966 are due either January 31, 1967, or March 15, 1967, according to the instructions on the back of the Form 9b.

Forms 8, 9b and 9X must be prepared on the basis of the calendar year even though your franchise or income tax return is filed on a fiscal year basis.

Only one Form 9X is required even though you may have a main office and one or more branch offices. Further instructions regarding the preparation and filing of Forms 8 and 9b are on the back of those forms.

I declare to the best of my knowledge and belief the Forms 8 submitted constitute a report of all stock transfers from Wisconsin residents, and the Forms 9b submitted constitute a true and complete statement of payments made and required to be reported by the corporation named at the head of this statement during the calendar year 1966.

W. Trent Turpin (Signature)

W. TRENT TURPIN
TAX COMPLIANCE COORDINATOR (Title of office held)

Date March 6, 1967

Mail Forms 8, and 9b with Form 9X to

WISCONSIN DEPARTMENT OF TAXATION
CORPORATION FRANCHISE AND INCOME TAX SECTION
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

WT-IC-830

3006

The State of Wisconsin

DEPARTMENT OF TAXATION

IN REPLY PLEASE REFER TO:
CORPORATION FRANCHISE AND
INCOME TAX SECTION
POST OFFICE BOX 59
MADISON, WISCONSIN 53701

February 28, 1967

Re: 99-40723

Humble Oil & Refining Company
Tax Department
Houston, Texas 77001

Attention: R. F. Heidner, Jr.
In regard to:
Your letter of: February 21, 1967

We have received your request for an extension of time in which to file:

☒ A 1966 Wisconsin corporation franchise or income tax return, Form 4.

☐ A complete 1966 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1966 return filed? Yes ☐ No ☐

☐ A 1966 Inventory report Form 10.

An extension of time to April 15, 1967 is hereby granted for the filing of your return(s) as indicated.

TAX RETURN - FORM 4

The maximum extension permitted by Section 71.10 (5) of the Wisconsin Statutes is 30 days, and your return will be considered timely filed if it is received on or before the date shown above. If no return is filed by that time the statutory $10.00 late filing fee will be assessed.

INVENTORY REPORT - FORM 10

This 30 day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

TAX PAYMENT

Any corporation franchise or income tax that is computed to be due on the complete return which was not paid by the original due date will be subject to extension interest at the rate of 5% per annum from the original due date to the end of the extension period, or the date of payment whichever is earlier. Any amount of tax computed to be due on the complete return that is not paid by the end of the extension period will be considered delinquent as of that date and will be subject to a 2% delinquent penalty and delinquent interest will be added at the rate of 1% per month from the date of delinquency until the date of payment.

ADDITIONAL TIME TO FILE THE COMPLETE FORM 4

If it is impossible to file a complete Form 4 within the extension period granted, a tentative return should be filed prior to the expiration of the extension period, and the complete return filed within 60 days after the close of the extension period. If the tentative return is filed within the extension period and the complete return is filed more than 60 days after the close of the extension period the 25% negligence penalty may be imposed unless it can be shown that the delayed filing was due to reasonable cause and not to negligence. Complete returns filed more than 60 days after the close of the extension period should contain a statement explaining the reason for the delayed filing.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

NOTE: Enclose one copy of this notice with your return.

3007

Page 3

Schedule E — COMPENSATION OF OFFICERS (See Instruction 8)

Name	Resident of What State?	Official Title	Per cent of Corporation Stock Owned: Common	Per cent of Corporation Stock Owned: Preferred	Amount of Compensation
Subtotal					
Less amount claimed in Schedule A					
Total to line 8, page 1					None

Schedule F — DEPRECIATION (See Instruction 12)

Character of Property	Rate (%) or Life	Amount of Depreciation: 1966	Amount of Depreciation: Accumulated Depreciation Allowed in Prior Years	Analysis of Asset Account: Balance Beginning of Year	Additions During Year	Assets Written Off During Year	Balance End of Year
[redacted]			← Total additional first-year depreciation (do not include in items below)				
Totals							
Less amount claimed in Schedule A							
Amount to line 12, page 1							

Schedules supporting deductions are voluminous but are available for inspection.

Schedule G — OTHER LOSSES* (See Instruction 14)

Kind of Loss	Amount
Bad Debts Charged Off	275,390
Total to line 14, page 1	275,390

*Savings and Loan Associations, Mutual Savings Banks and Credit Unions, see instruction 14

Schedule H — TAXES (See Instruction 15)

Kind of Tax	Date Paid: Month	Date Paid: Year	Amount
1. Wisconsin franchise and/or income:			
a. Paid in 1966 on 1965 income			
b. Paid in 1966 on 1966 income			
2. Real estate			308,429
3. Personal property			
Federal and State Employer Taxes			85,294
Permits and Licenses			9,712
Other			1,245
Subtotal			
Less amount claimed in Schedule A			
Total to line 15, page 1			404,680

CHECKED BY [illegible]

1. Location of books and records for audit purposes: 800 Bell Avenue (Street and Number) Houston (City) Texas (State)

2. Method of filing — see General Instruction D: Cash ☐ Accrual ☒

3. (a) Attach list of corporations in which you own, directly or indirectly, 50% or more of the outstanding voting stock. Exhibit I Attached
(b) Have the incomes of these affiliated corporations been included in this return? Yes ☐ No ☒

4. (a) Give the names of any corporations, individuals, partnerships, trusts or associations which own 50% or more of your outstanding voting stock: Standard Oil Company (New Jersey), 100%
(b) Have the incomes of any of these organizations been included in this return? Yes ☐ No ☒

5. Did you sell to or buy from any individual or organization listed in items 3 or 4 above? Yes ☒ No ☐ If yes, insert approximate amount of such sales $ Not available at this time. purchases $ Not available at this time. and attach explanations of how transfer prices were determined.

6. If your corporation has been involved in any reorganization during the period covered by this return, attach a detailed explanation.

7. Insert your Wisconsin withholding tax employer's identification number 32803 If none, write none

8. Insert your Wisconsin seller's permit number 39561-Various If none, write none or use tax number 39561 If none, write none

Page 4

Schedule I — OTHER ORDINARY AND NECESSARY EXPENSES

Kind of Expense	
Commissions	699,429
Travel, Trade & Moving	82,484
Painting	83,837
Installation & Removal	46,653
Credit & Collection	63,735
Sales Promotion	117,179
Products Consumed	23,165
Postage, Stationery & Supplies	100,119
Outside Transportation	106,053
Fuel, Light & Power	63,704
Telephone & Telegraph	37,973
Outside Services	55,423
Administrative Expenses	120,137
Area Expenses	552,067
Misc. Marketing Expense	19,059
Other Misc. Expenses	2,628
Casualty Losses	9,730
Rents	2,183,147
Advertising	426,933
Pension, profit sharing, stock bonus and annuity plans	
Other employee benefit plans	
Total to line 18, page 1	2,610,108

Schedule X — U.S. INCOME TAXES

1. Paid in 1966 on 1965 income	
2. Paid in 1966 on 1966 income	
3. Additional assessments paid in 1966 on incomes of prior years	
4. Total	
5. Amount deductible (limited to 10% of line 20, page 1 — to line 21, page 1)	
6. Non-deductible portion (line 4 minus line 5 — to line 4, Schedule L)	None

TAX RATE SCHEDULE (See instruction F)

If the net income is:	The amount of franchise or income tax is:
Not over $1,000	2% of net income
Over $1,000 but not over $2,000	$ 20 plus 2½% of excess over $1,000
Over $2,000 but not over $3,000	$ 45 plus 3 % of excess over $2,000
Over $3,000 but not over $4,000	$ 75 plus 4 % of excess over $3,000
Over $4,000 but not over $5,000	$115 plus 5 % of excess over $4,000
Over $5,000 but not over $6,000	$165 plus 6 % of excess over $5,000
Over $6,000	$225 plus 7 % of excess over $6,000

Corporations reporting in excess of $6,000.00 net income may use a short cut method of tax computation by multiplying their net income by 7% and subtracting $195.00.

CHECKED BY COMPTOMETER

Schedule Z — DISTRICTS FROM WHICH INCOME IS DERIVED

THIS SCHEDULE MUST BE COMPLETED BY ALL CORPORATIONS WHICH DERIVE THEIR INCOME FROM MORE THAN ONE MUNICIPALITY

Enter the legal name of each municipality, checking the proper city, village or town block, and the name of the appropriate county in which a portion of your income was derived. If your operation in each of the various municipalities listed was an integral part of a unitary business, the amount of property (net value, but include inventory), cost of manufacturing, and sales attributable to each municipality must be inserted in the proper column. If any factor for a particular municipality is zero, insert "none" in the column.

If the operation in each of the various municipalities listed was not an integral part of a unitary business, and if the net profit in each location can be accurately determined in accordance with Section 71.07, such net profit figure for each municipality may be submitted in the last column in lieu of the data required in the preceding three columns.

DISTRICT					AMOUNT			
Name	Check one: City	Vil.	Town	County	Property	Cost of Manufacturing	Sales	Net Profit
				Schedule Z-1 Attached				
Totals								

DECLARATION

We, the undersigned, president (or vice-president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, each for himself declares that this return (including any accompanying schedules and statements) has been personally examined by him and is, to the best of his knowledge and belief, a true and correct report of income under the provisions of Chapter 71 of the Wisconsin Statutes.

Signature	Vice President — Title	April 14, 1967 — Date
Signature	Assistant Treasurer — Title	April 14, 1967 — Date
Individual or firm signature of preparer	Address	Date

EXHIBIT 11-7C

11-7C Exhibit 7C 3008

WT-IC-040 **WISCONSIN CORPORATION FRANCHISE OR INCOME TAX RETURN** FORM 4

RECEIVED APR 17 1968 WIS. TAX BUREAU

FOR STATE, COUNTY AND MUNICIPAL REVENUES 1967 or other income year: Beginning 10-2-74 Ending

Ex 11-7C KC3

Due the 15th day of the third month following the close of the income year. Mail to: WISCONSIN DEPARTMENT OF REVENUE, Corporation Franchise and Income Tax Bureau, Post Office Box 98, Madison, Wisconsin 53701

LEAVE BLANK: File No. 99 40723; Type 3A; Form 4-68 4ES; Late Fee ☐ Inv. Report Fee ☐

A. Name	B. State of Incorporation	C. Year of Incorporation	D. Bus. Code No.
Humble Oil & Refining Company	Delaware	1959	1310

E. Mailing Address: Street and Number: 800 Bell Avenue; City: Houston; State: Texas; Zip Code: 77002

F. If all your income is derived from within one municipality, complete blocks G and H. If your income is derived from more than one municipality, complete Schedule Z, page 4. G. City ☐ Village ☐ or Town ☐ of H. County of

Leave Blank: AAFA-73

INCOME	1. Gross receipts or gross sales, less returns and allowances	16,281,720
	2. Cost of goods sold (Schedule A) or cost of operations (attach schedule)	10,888,422
	3. Gross profit — FIELD AUDITED	5,393,298
	4. Gross dividends (Schedule B)	
	5. Profits (losses) from disposal of capital assets (Schedule C) (Loss)	(7,152)
	6. All other income (Schedule D)	573,866
	7. Total income from all sources	5,960,012
DEDUCTIONS	8. Compensation of officers (Schedule E)	1,664,482
	9. Wages and bonuses	363,504
	10. Repairs	80,319
	11. Bad debts and other losses (Schedule F)	628,380
	12. Rents	520,442
	13. Taxes (Schedule G)	2,700
	14. Interest	30,366
	15. Depletion and amortization (attach schedule)	618,592
	16. Depreciation (Schedule H)	383,248
	17. Advertising	
	18. Pension, profit sharing, stock bonus, annuity plans	
	19. Other employee benefit plans	
	20. Deductible dividends received (Schedule B)	
	21. Other ordinary and necessary expenses (Schedule I)	2,694,203
	22. Total (lines 8 through 21)	6,986,236
	23. Subtotal (line 7 minus line 22) (Loss)	(1,026,224)
	24. U. S. income taxes (not in excess of 10% of line 23) (Schedule X)	
	25. Subtotal (Loss)	(1,026,224)
	26. Contributions (not in excess of 5% of line 25) (attach schedule)	
	27. Subtotal (Loss)	(1,026,224)
	28. Unused 1965 net business loss offset	
	29. 1966 net business loss offset	
	30. Net income (Loss)	(1,026,224)

TO BE COMPLETED ONLY BY CORPORATIONS REPORTING ON THE APPORTIONMENT METHOD (Form 4B)

APPORTIONMENT		Leave Blank
	31. Total company net non-apportionable income (loss)—item (T), line 13, Form 4B	
	32. Apportionable income (line 30 minus line 31)	
	33. Per cent to Wisconsin (line 28 Form 4B) %	
	34. Amount to Wisconsin	
	35. Wisconsin net non-apportionable income (loss)—item (W), line 13, Form 4B	
	36. Wisconsin net income	
	37. Wisconsin sales $	0 1 2 3 4 5 6 7

CHECKED BY JTU COMPTOMETER

	TAX	Leave Blank
38. Total tax (see instruction F)	None	
39. Less: Declaration installments paid (Form 4-ES)	2,500	2500.00
40. Other payments and credits		
41. Balance due — attach remittance		
42. Overpayment — complete line 43	2,500	
43. Enter amount of overpayment you want: credited on 1969 ESTIMATED * $ 2,500	44. Refunded $	

* Apply credit against Wisconsin tax bill #A-2383 on file number 99-40723

UFT 3 6 0 2 3 1 7 8 .00

Page 2

Schedule A — COST OF GOODS SOLD (See Instruction 2)

1. Inventory at beginning of year (complete lines 9 and 10)	338,826
2. Merchandise purchased for manufacturing	-
3. Merchandise purchased for resale	11,013,900
4. Salaries and wages	-
5. Cost of manufacturing (submit schedule)	-
6. Total	11,352,726
7. Inventory at end of year	(464,304)
8. Cost of goods sold to line 2, page 1	10,888,422

9. Have you included Form 107 Yes ☐ No ☐ See General Instructions K-4

10. Has your method of inventory valuation changed? Yes ☐ No ☒ If yes, attach explanation.

Schedule B — DIVIDENDS (See Instruction 4)

Name of Declaring Corporation	Gross Dividends	Deductible Dividend Received
Gross dividend income to line 4, page 1	None	
Deductible dividends received to line 20, page 1		None

Schedule C — PROFITS (LOSSES) FROM DISPOSAL OF CAPITAL ASSETS (See Instruction 5)

Kind of Property	Situs Wis.	Situs Outside	Cost or Other Basis	Depreciation Allowed or Allowable	Net Tax Cost	Gross Sales Price less Expense of Sale	Profit (Loss)
Detailed records are maintained by taxpayer and are available for inspection							
Total to line 8, page 1							

Schedule D — ALL OTHER INCOME (See Instruction 6)

1. Interest from obligations of the United States and its instrumentalities*	
2. Interest from State and Municipal obligations	
3. Interest from securities (except amounts required on lines 1 and 2)	
4. All other interest	16,751
5. Rent	487,738
6. Royalties from tangible property	
7. Royalties from patents and intangible property	
8. Collections of accounts written off in previous years	
9. Tax refunds.	
State gasoline tax allowance	62,366
Other income	7,011
Total to line 6, page 1	573,866

*Interest from obligations of the United States and its instrumentalities is not taxable income for corporations subject to income tax. See introduction to instruction booklet.

CHECKED BY JTU COMPTOMETER

WT-4C-042
Wisconsin Department of Revenue

Please refer to page 5 of Instruction Booklet WT-IC-100

FORM 4A

NOTE: A copy of the balance sheet and related schedules submitted with your Form 1120 may be filed in lieu of Schedule J.

BALANCE SHEETS OF Humble Oil & Refining Company
Name of Corporation

Schedule J	December 31, 1966 or other income year ending (A) Amount	December 31, 1966 or other income year ending (B) Total	December 31, 1967 or other income year ending (C) Amount	December 31, 1967 or other income year ending (D) Total
ASSETS				
1. Cash				
2. Trade notes and accounts receivable				
(a) Less allowance for bad debts				
3. Inventories				
4. Gov't obligations: (a) U.S. & instrumentalities				
(b) State, subdivisions thereof, etc.				
5. Other current assets (attach schedule)				
6. Loans to stockholders				
7. Mortgage and real estate loans				
8. Other investments (attach schedule)				
9. Buildings and other fixed depreciable assets				
(a) Less accumulated depreciation				
10. Depletable assets		Schedule J-1		
(a) Less accumulated depletion		Attached		
11. Land (net of any amortization)				
12. Intangible assets (amortizable only)				
(a) Less accumulated amortization				
13. Other assets (attach schedule)				
14. Total assets				
LIABILITIES AND CAPITAL				
15. Accounts payable				
16. Mtges., notes, bonds payable in less than 1 yr.				
17. Other current liabilities (complete schedule J-1)				
18. Loans from stockholders				
19. Mtges., notes, bonds payable in 1 yr. or more				
20. Other liabilities (complete schedule J-2)				
21. Capital stock: (a) Preferred stock				
(b) Common stock				
22. Paid-in or capital surplus (attach reconciliation)				
23. Retained earnings—Appropriated (attach sch.)	(A)		(B)	
24. Retained earnings—Unappropriated				
25. Less cost of treasury stock		( )		( )
26. Total liabilities and capital				

(A) and (B)—See lines 1 and 14, Schedule K

Schedule J-1 Other Current Liabilities

Title of Account	Account Balance Beginning of Year	Account Balance End of Year
Accrued State Franchise or Income Tax		
Accrued Federal Income Tax		
Accrued Local Property Tax		
Total Other Current Liabilities (line 17)		

Schedule J-2 Other Liabilities

Title of Account	Account Balance Beginning of Year	Account Balance End of Year
(Contingent or Surplus Reserves)		
Total Other Liabilities (line 20)		

Schedule K — **ANALYSIS OF RETAINED EARNINGS**

1. Balance at beginning of income year (must agree with item (A), line 24, Schedule J)		2,458,032,331
Amounts credited to retained earnings:		
2. Book income (see line 1, Schedule L)	599,874,220	
3. Other credits to retained earnings (itemize)		
4.		
5.		
6.		
7.		
Subtotal		
Amounts debited to retained earnings:		
8. Cash dividends (a) Preferred ... (date paid ... 19...)		
(b) Common ... (date paid ... 19...)	370,000,000	
9. Stock dividends ... (date paid ... 19...)		
10. Other debits to retained earnings (itemize)		
11.		
12.		
13.		
14. Balance at end of income year (must agree with item (B), line 24, Schedule J)		2,687,906,551

Schedule L — **RECONCILIATION OF BOOK INCOME WITH NET INCOME**

1. Book income (must agree with line 2, Schedule K)	
Add adjustments to arrive at net income:	
2. Premiums paid on corporate life insurance policies	
3. Unallowable contributions	
4. Non-deductible portion of U. S. income taxes paid (line 6, Schedule X)	
5. Athletic and social club dues	
6.	
7.	
8. Schedule O Completed in Lieu of Schedule L	
9.	
10.	
11.	
12. Additions to surplus reserves charged against book income:	
(a) Wisconsin franchise and income tax	
(b) U. S. income tax	
(c)	
(d)	
(e)	
Subtotal	
Deduct adjustments to arrive at net income:	
13. Deductible dividends received (Schedule B)	
14. Non-taxable stock dividends received	
15. Net business loss offset (lines 28 and 29, page 1)	
16. Increase in cash value of life insurance	
17.	
18.	
19.	
20.	
21.	
22.	
23.	
24. Charges made on books against surplus reserves:	
(a) Wisconsin franchise and income tax	
(b) U. S. income tax	
(c)	
(d)	
(e)	
25. Net income (line 30, page 1, Form 4)	

3010

WT-IC-044
Wisconsin Department of Revenue

Form 4C

IMPORTANT — REFER TO GENERAL INSTRUCTION J OF INSTRUCTION BOOKLET WT-IC-100

Schedule N — 1967 SEPARATE ACCOUNTING DATA OF Humble Oil & Refining Company
Name of corporation

INCOME	1. Wisconsin	2. Outside	3. Total
Gross operating revenue	16,281,720	3,685,326,049	3,701,607,769
Cost of Goods Sold:			
Beginning Inventory	338,826	228,429,963	228,768,789
Purchases & Manufacturing Costs	11,013,900	2,579,665,883	2,590,679,783
Closing Inventory	(464,304)	(260,486,930)	(260,951,234)
Cost of Goods	10,888,422	2,547,608,916	2,558,497,338
Gross Profit	5,393,298	1,137,717,133	1,143,110,431
Deduct:			
Marketing Expense	6,942,297	406,259,576	413,201,873
Administrative Expense	116,666	44,785,741	44,902,407
Total	7,058,963	451,045,317	458,104,280
Total income (Loss) from Operations	(1,665,665)	686,671,815	685,006,151

EXPENSES	Basis of Allocation			
Net Operating Revenue:				
Royalties			163,444	163,444
Interest		16,751	2,998,178	3,014,929
Dividends			18,113,802	18,113,802
Rent Income		487,738	(487,738)*	
Other (Charges) & Credits				
Interest		(2,700)	(8,206,613)	(8,209,313)
Income Taxes			(101,331,781)	(101,331,781)
Other		62,225	3,054,763	3,116,988
Net Profit (Loss) Carried to Surplus		(1,101,651)	600,975,871	599,874,220
Total expenses				
Book Income				

*The rental income of Humble Oil & Refining Company outside Wisconsin has been netted against the Departmental Expenses. Since this is an item which can be clearly accounted for on a direct basis, we do not feel that it is necessary to go back and set out the "Outside Wisconsin" and the "Everywhere" amounts.

When Form 4C is used, Schedule O must be completed in place of Schedule L. The book income in column 3 must agree with line 2, Schedule K.

(over)

Schedule O RECONCILIATION OF BOOK INCOME WITH NET INCOME

	1. Wisconsin	2. Outside	3. Total
1. Book income (must agree with Schedule N) ....(Loss).....	(1,101,651)	600,975,871	599,874,220
Add adjustments to arrive at net income:			
2. Premiums paid on corporate life insurance policies			
3. Unallowable contributions			
4. Non-deductible portion of U. S. income taxes paid (line 6, Schedule X)			
5. Athletic and social club dues			
6. Depreciation not deductible	75,427		75,427
7.			
8.			
9.			
10.			
11.			
12. Additions to surplus reserves charged against book income:			
(a) Wisconsin franchise and income tax			
(b) U. S. income tax			
(c)			
(d)			
(e)			
Subtotal	(1,026,224)	*	599,949,647
Deduct adjustments to arrive at net income:			
13. Deductible dividends received (Schedule B)			
14. Non-taxable stock dividends received			
15. Net business loss offset (lines 28 and 29, page 1)			
16. Increase in cash value of life insurance			
17.			
18.			
19.			
20.			
21.			
22.			
23.			
24. Charges made on books against surplus reserves:			
(a) Wisconsin franchise and income tax			
(b) U. S. income tax			
(c)			
(d)			
(e)			
Subtotal			
25. Net income (line 30, page 1) .....(Loss).....	(1,026,224)		
26. Net income (Outside and Total)		600,975,871	599,949,647

27. Were any products or supplies transferred between Wisconsin branches and branches outside Wisconsin? Yes ☒ No ☐

If yes, insert the approximate amount of transfers into Wisconsin $ Not available at this time, and out of Wisconsin $ Not available at this time

and attach explanation of how transfer prices were determined.

28. Explain bases used to allocate expenses within and without Wisconsin Expenses deducted are actually incurred in Wisconsin with the exception of overhead which is allocated on the basis of sales.

* Detailed adjustments outside Wisconsin are not yet available and will not be until such time as the Federal return is completed. If such detail is required, please notify us and we will be glad to furnish it.

3011

HUMBLE OIL & REFINING COMPANY
1967 WISCONSIN STATE INCOME TAX
SCHEDULE Z

NAME	TOWN	VILLAGE	CITY	COUNTY	SALES	PROPERTY
DePere			X	Brown	$ 37,285	$ 36,066
Green Bay			X	Brown	407,694	394,361
Columbus			X	Columbia	18,398	17,797
Wisconsin Dells			X	Columbia	11,886	11,497
DeForest		X		Dane	90,201	87,251
Madison			X	Dane	556,835	538,624
Beaver Dam			X	Dodge	34,680	33,546
Clyman		X		Dodge	651	630
Watertown			X	Dodge	244,063	236,081
Sturgeon Bay			X	Door	17,910	17,324
Ripon			X	Fond du Lac	41,193	39,846
Waupun			X	Fond du Lac	42,007	40,633
Ft. Atkinson			X	Jefferson	1,303	1,260
Lake Mills			X	Jefferson	89,061	86,148
Kenosha			X	Kenosha	182,578	176,549
Tomahawk			X	Lincoln	20,189	19,529
Kiel			X	Manitowoc	23,934	23,151
Manitowoc			X	Manitowoc	67,244	65,045
Two Rivers			X	Manitowoc	27,679	26,774
Mosinee			X	Marathon	1,140	1,102
Schofield			X	Marathon	38,425	37,168
Wausau			X	Marathon	98,504	95,283
Bay Side		X		Milwaukee	42,658	41,263
Brown Deer		X		Milwaukee	74,896	72,446
Fox Point			X	Milwaukee	103,063	99,693
Glendale			X	Milwaukee	76,361	73,864
Greendale			X	Milwaukee	167,539	162,060
Greenfield			X	Milwaukee	49,822	48,193
Hales Corners		X		Milwaukee	283,628	274,352
Milwaukee			X	Milwaukee	7,891,098	7,633,018
Oak Creek			X	Milwaukee	236,248	228,521
South Milwaukee			X	Milwaukee	156,956	151,823
Wawwatosa			X	Milwaukee	154,676	149,618
West Allis			X	Milwaukee	106,645	103,157
Appleton			X	Outagamie	66,755	64,572
Kimberly		X		Outagamie	34,680	33,546
Little Chute	X			Outagamie	65,453	63,312
Belgium		X		Ozaukee	37,122	35,908
Cedarburg			X	Ozaukee	44,286	42,838
Mequon			X	Ozaukee	95,899	92,763
Pt. Washington			X	Ozaukee	79,129	76,541
Saukville	X			Ozaukee	97,039	93,865
Thiensville		X		Ozaukee	81,083	78,431

3012

Schedule Z

Page 2

NAME	TOWN	VILLAGE	CITY	COUNTY	SALES	PROPERTY
Almond		X		Portage	$ 8,792	$ 8,505
Amherst			X	Portage	3,256	3,150
Arnott		X		Portage	1,465	1,417
Custer		X		Portage	6,676	6,457
Nelsonville		X		Portage	2,279	2,205
Plover			X	Portage	47,543	45,988
Rosholt			X	Portage	4,885	4,725
Stevens Point			X	Portage	269,462	260,650
Burlington			X	Racine	169,107	163,634
Racine			X	Racine	598,353	578,784
Sturtevant			X	Racine	151,908	146,940
Waterford			X	Racine	50,636	48,980
Afton		X		Rock	31,912	30,868
Beloit			X	Rock	108,273	104,732
Edgerton			X	Rock	51,776	50,083
Janesville			X	Rock	69,360	67,092
Orfordville	X			Rock	8,141	7,875
So. Beloit	X			Rock	48,031	46,460
Franklin			X	Sheboygan	125,858	121,742
Sheboygan			X	Sheboygan	239,016	231,199
Sheboygan Falls			X	Sheboygan	12,211	11,812
Delavan			X	Walworth	68,058	65,832
Elk Horn		X		Walworth	58,126	56,225
Lake Geneva			X	Walworth	37,936	36,696
Germantown	X			Washington	36,308	35,121
West Bend			X	Washington	59,591	57,642
Brookfield			X	Waukesha	584,025	564,925
Butler		X		Waukesha	95,085	91,975
Delafield			X	Waukesha	106,320	102,842
Elm Grove		X		Waukesha	119,671	115,757
Lannon		X		Waukesha	57,963	56,067
Menomonee Falls		X		Waukesha	288,838	279,391
Muskego	X			Waukesha	47,868	46,303
New Berlin				Waukesha	138,720	134,183
Oconomowoc			X	Waukesha	10,746	10,394
Okauchee	X			Waukesha	26,214	25,356
Pewaukee		X		Waukesha	50,148	48,508
Waukesha			X	Waukesha	301,375	291,518
Menasha			X	Winnebago	977	945
Neenah			X	Winnebago	95,085	91,975
Oshkosh			X	Winnebago	51,450	49,768
Wisconsin Rapids	X			Wood	40,380	39,058
1/ GRAND TOTAL					$16,281,720	$15,749,228

CHECKED BY JTU COMPUTER

WT-IC-090

1967

3013

FORM 9X

File No. 99-112753

RECEIVED

MAR 4 1968

WIS. REVENUE
CORPORATION FRANCHISE
& INCOME TAX BUREAU

WISCONSIN

Corporation Annual Information Return

SUMMARY OF REPORTS OF SALARY, WAGE, INTEREST, DIVIDEND AND RENT PAYMENTS AND TRANSFERS OF CAPITAL STOCK

FOR THE CALENDAR YEAR 1967

Name	State of Incorporation
Humble Oil & Refining Company, Attention Sam Farrell	Delaware
Mailing Address Street and Number / City / State	Zip Code
P. O. Box 2180, Houston, Texas	77001

Indicate in the spaces below the total number of Forms 8 and 9b submitted:

	Filed with this report	Previously filed
FORMS 8		-
FORMS 9b	145	-

Have Forms WT-7 and WT-9 been submitted to The Wisconsin Department of Taxation, Post Office Box 34, Madison, Wisconsin 53701 in accordance with the Provisions of Sections 71.10(8m), 71.10(8n), and 71.20(4) of The Wisconsin Statutes?

Check one

YES ☒
NO ☐

If the above answer is yes, state the total number of Forms WT-9 filed (From line 1, Form WT-7)	1820
State the amount of Wisconsin income tax withheld as shown on all Forms WT-9 filed (From line 2, Form WT-7)	$ 88,179.15
Insert your Wisconsin employer identification number	32803

INSTRUCTIONS

Form 9X must be filed by all corporations regardless of whether it is necessary to file Forms 8 and 9b. The 1967 Form 9X is due by March 15, 1968. Forms 8 for 1967 are due by March 15, 1968. Forms 9b for 1967 are due either January 31, 1968, or March 15, 1968, according to the instructions on the back of the Form 9b.

Forms 8, 9b and 9X must be prepared on the basis of the calendar year even though your franchise or income tax return is filed on a fiscal year basis.

Only one Form 9X is required even though you may have a main office and one or more branch offices. Further instructions regarding the preparation and filing of Forms 8 and 9b are on the back of those forms.

I declare to the best of my knowledge and belief the Forms 8 submitted constitute a report of all stock transfers from Wisconsin residents, and the Forms 9b submitted constitute a true and complete statement of payments made and required to be reported by the corporation named at the head of this statement during the calendar year 1967.

W. Trent Turpin
(Signature)

W. TRENT TURPIN
TAX COMPLIANCE COORDINATOR
(Title of office held)

Date February 28, 1968

Mail Forms 8, and 9b with Form 9X to

WISCONSIN DEPARTMENT OF TAXATION
CORPORATION FRANCHISE AND INCOME TAX SECTION
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

IC-830

3014

State of Wisconsin \ DEPARTMENT OF REVENUE

CORPORATION FRANCHISE AND
INCOME TAX BUREAU
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

February 21, 1968

Re: 99-40723

Humble Oil & Refining Company
P. O. Box 2180
Houston, Texas 77001

Attention: R. F. Haidner, Jr.
In regard to:
Your letter of: February 16, 1968

We have received your request for an extension of time in which to file:

☒ A 1967 Wisconsin corporation franchise or income tax return, Form 4.

☐ A complete 1967 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1967 return filed? Yes ☐ No ☐

☐ A 1967 Inventory report Form 10.

An extension of time to April 15, 1968 is hereby granted for the filing of your return(s) as indicated.

TAX RETURN - FORM 4

The maximum extension permitted by Section 71.10(5) of the Wisconsin Statutes is 30 days, and your return will be considered timely filed if it is received on or before the date shown above. If no return is filed by that time the statutory $10.00 late filing fee will be assessed.

INVENTORY REPORT - FORM 10

This 30 day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

TAX PAYMENT

Any corporation franchise or income tax that is computed to be due on the complete return which was not paid by the original due date will be subject to extension interest at the rate of 5% per annum from the original due date to the end of the extension period, or the date of payment whichever is earlier. Any amount of tax computed to be due on the complete return that is not paid by the end of the extension period will be considered delinquent as of that date and will be subject to a 2% delinquent penalty and delinquent interest will be added at the rate of 1% per month from the date of delinquency until the date of payment.

ADDITIONAL TIME TO FILE THE COMPLETE FORM 4

If it is impossible to file a complete Form 4 within the extension period granted, a tentative return should be filed prior to the expiration of the extension period, and the complete return filed within 60 days after the close of the extension period. If the tentative return is filed within the extension period and the complete return is filed more than 60 days after the close of the extension period the 25% negligence penalty may be imposed unless it can be shown that the delayed filing was due to reasonable cause and not to negligence. Complete returns filed more than 60 days after the close of the extension period should contain a statement explaining the reason for the delayed filing.

NOTE: Enclose one copy of this notice with your return.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

IC-830

3015

State of Wisconsin \ DEPARTMENT OF REVENUE

CORPORATION FRANCHISE AND
INCOME TAX BUREAU
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

February 21, 1968

Re: 99-40723

Humble Oil & Refining Company
P. O. Box 2180
Houston, Texas 77001

Attention: R. F. Haidner, Jr.
In regard to:
Your letter of: February 16, 1968

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☒ A 1967 Wisconsin corporation franchise or income tax return, Form 4.

☐ A complete 1967 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1967 return filed? Yes ☐ No ☐

☐ A 1967 Inventory report Form 10.

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INVENTORY REPORT - FORM 10

This 30 day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

TAX PAYMENT

Any corporation franchise or income tax that is computed to be due on the complete return which was not paid by the original due date will be subject to extension interest at the rate of 5% per annum from the original due date to the end of the extension period, or the date of payment whichever is earlier. Any amount of tax computed to be due on the complete return that is not paid by the end of the extension period will be considered delinquent as of that date and will be subject to a 2% delinquent penalty and delinquent interest will be added at the rate of 1% per month from the date of delinquency until the date of payment.

ADDITIONAL TIME TO FILE THE COMPLETE FORM 4

If it is impossible to file a complete Form 4 within the extension period granted, a tentative return should be filed prior to the expiration of the extension period, and the complete return filed within 60 days after the close of the extension period. If the tentative return is filed within the extension period and the complete return is filed more than 60 days after the close of the extension period the 25% negligence penalty may be imposed unless it can be shown that the delayed filing was due to reasonable cause and not to negligence. Complete returns filed more than 60 days after the close of the extension period should contain a statement explaining the reason for the delayed filing.

NOTE: Enclose one copy of this notice with your return.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

A. 686

3016

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
W. TRENT TURPIN
COORDINATOR
TAX COMPLIANCE

February 16, 1968

RECEIVED
FEB 20 1968
WIS. DEPT. OF REVENUE
CORPORATION FRANCHISE
& INCOME TAX BUREAU

CJH 11-7-67

99-40723
Ca2

Department of Taxation
State of Wisconsin
Madison, Wisconsin 53701

Gentlemen:

Since the corporate books of Humble Oil & Refining Company are not closed until a late date, and since the information to be gathered for the preparation of financial statements, once the books are closed, is so voluminous, it would be very difficult to properly prepare and file the Wisconsin Corporation Income Tax Return by March 15, 1968.

We gratefully acknowledge your cooperation in prior years and shall appreciate very much your favorable consideration of this request for an extension until April 15, 1968 for filing this return.

A tentative return will be filed if requested.

Yours very truly,

RF Heidner Jr.
R. F. Heidner, Jr.

RJS/mm

A. 687

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
W. TRENT TURPIN
COORDINATOR
TAX COMPLIANCE

February 21, 1967

RECEIVED
FEB 24 1967
WIS. DEPT. OF TAXATION
CORPORATION FRANCHISE
& INCOME TAX SECTION

99-4072233017
Chg
G.S

Department of Taxation
State of Wisconsin
Madison 2, Wisconsin

Gentlemen:

Since the corporate books of Humble Oil & Refining Company are not closed until a late date, and since the information to be gathered for the preparation of financial statements, once the books are closed, is so voluminous, it would be very difficult to properly prepare and file the Wisconsin Corporation Income Tax Return by March 15, 1967.

We gratefully acknowledge your cooperation in prior years and shall appreciate very much your favorable consideration of this request for an extension until April 15, 1967 for filing this return.

A tentative return will be filed if requested.

Yours very truly,

RF Heidner Jr.
R. F. Heidner, Jr.

TOF/ju

A. 688

3018

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
W. TRENT TURPIN
COORDINATOR
TAX COMPLIANCE

April 15, 1968

RECEIVED
APR 17 1968
WIS. DEPT. OF REVENUE
CORPORATION FRANCHISE
& INCOME TAX BUREAU

Wisconsin Department of Taxation
Corporation Franchise & Income Tax Section
Post Office Box 98
Madison, Wisconsin 53701

Gentlemen:

Enclosed is the 1967 Wisconsin Corporation Franchise Tax Return for Humble Oil & Refining Company, reflecting a loss of $1,026,224 from Wisconsin operations during the calendar year 1967.

Please credit the overpayment of declaration installments against Humble's liability on Wisconsin tax bill #A-2383, file number 99-40723, pursuant to Wisconsin Statutes §71.09(10).

We appreciate very much your cooperation in granting us an extension of time until April 15, 1968 within which to file the return.

Yours very truly,

R F Heidner Jr.

R. F. Heidner, Jr.

RJS/mm

Attachments

A. 689

3019

Form 4-ES

DECLARATION OF ESTIMATED TAX
(This Form To Be Filed At The Address Shown Below)

1967

FILE NO. 99-40723

Leave Blank

Corporation name: Humble Oil & Refining Company

Address: 800 Bell Avenue

City: Houston

State: Texas

Zip: 77002

Leave Blank 4

THIS DECLARATION IS FOR: (Check One) ☒ Calendar year 1967, ☐ Fiscal year beginning _____ 19 ____ and ending _____ 19 ____

1. Estimate of 1967 Wisconsin franchise or income tax ..... $ 2500
2. Enter ¼ of line 1, unless:
   This declaration is ☐ an amended declaration ☐ a declaration for an income period of less than 12 months ☒ a declaration filed after the 15th day of the 3rd month of the income year
   Check proper box and refer to Instruction Booklet WT-IC-100 for the computation of the amount for line 2. $ 2500
3. Total Tax on complete 1966 Form 4 (Line 35) $ None, or not yet filed ☐ ..... $ 2500
   Enter 1967 credit from complete 1966 Form 4 (Line 40) ..... $ -
4. If an amended declaration enter amount of 1967 installments previously paid ..... $ 2500
5. Deduct total credits to be applied on this installment (Total of lines 3 and 4) ..... $ None
6. Balance to be paid with this declaration (Line 2 less line 5) ..... $

Original declarations and 1st installments are due on or before the 15th day of the 3rd month of the income year; other types of declarations see Instruction Booklet WT-IC-100 for due dates.

I declare under the penalties of perjury that this declaration has been examined by me and to the best of my knowledge is a true, correct and complete declaration.

Signature [signature] Title Assistant Secretary Date April 14, 1967

MAKE CHECKS PAYABLE TO: Wisconsin Dept. of Taxation

Leave Blank #16 6/10 .00 #

10053 4/16/67

Wisconsin Department of Taxation
Corp. Franchise and Income Tax Sec.
Post Office Box 98
Madison, Wisconsin 53701

3019

FISCAL SUMMARY - CORPORATION DECLARATION FISCAL YEAR ENDING 1267

FILE NO. 9940723

NAME AND ADDRESS HUMBLE OIL & REFINING CO 800 BELL AVE HOUSTON TEX

DECLARATION AMT. CREDITS VAL.NO. VAL.CATE PAYMENTS

$	2,500.00	$	1CC53	4-16-67	
$		$	2,500.00	33427	5-20-67

TOTAL CREDITS 2,500.00 TOTAL PAYMENTS $ .00

TOTAL CREDITS AND PAYMENTS $ 2,500.00

3020

3021

Page 3

Schedule E — COMPENSATION OF OFFICERS (See Instruction 8)

Name	Resident of What State?	Official Title	Per cent of Stock Owned: Common	Per cent of Stock Owned: Preferred	Amount of Compensation
Subtotal					
Less amount claimed in Schedule A. Total to line 6, page 1					None

Schedule F — BAD DEBTS AND OTHER LOSSES (See Instruction 11)

Kind of Loss	Amount
Bad Debts charged off	80,319
Total to line 11, page 1	80,319

*Savings and Loan Associations, Mutual Savings Banks and Credit Unions, see instruction 11.

Schedule G — TAXES (See Instruction 13)

Kind of Tax	Date Paid: Month	Date Paid: Year	Amount
1. Wisconsin franchise and/or income:			
a. Paid in 1967 on 1967 income			
b. Paid in 1967 on 1966 income			
2. Real estate			360,250
3. [redacted] Permits			10,511
Federal and State			
Employer Taxes			148,136
Other			1,545
Subtotal			520,442
Less amount claimed in Schedule A. Total to line 13, page 1			- 520,442

Schedule H — DEPRECIATION (See Instruction 16)

Character of Property	Rate (%) or Life	Amount of Depreciation: 1967	Amount of Depreciation: Accumulated Depreciation Allowed in Prior Years	Analysis of Asset Account: Balance Beginning of Year	Analysis of Asset Account: Additions During Year	Analysis of Asset Account: Assets Written Off During Year	Analysis of Asset Account: Balance End of Year
			← Total additional first-year depreciation (do not include in items below)				
Buildings							
Furniture and Fixtures							
Transportation Equip.							
Machinery and other Equip.							
Other (Specify)							
Totals							
Less amount claimed in Schedule A. Amount to line 16, page 1							

Schedules supporting deductions are voluminous but are available for inspection.

1. Location of books and records for audit purposes: 800 Bell Avenue, Houston, Texas (Street and Number, City, State)
2. Method of filing — see General Instruction D. Cash ☐ Accrual ☒
3. (a) Principal Business Activity Marketing petroleum prods (b) Principal Product or Service petroleum products (See General Instruction C and complete Block D, Page 1.)
4. (a) Attach list of corporations in which you own, directly or indirectly, 50% or more of the outstanding voting stock.
   (b) Have the incomes of these affiliated corporations been included in this return? Yes ☐ No ☒
5. (a) Give the names of any corporations, individuals, partnerships, trusts or associations which own 50% or more of your outstanding voting stock. Standard Oil Company (New Jersey)
   (b) Have the incomes of any of these organizations been included in this return? Yes ☐ No ☒
6. Did you sell to, or buy from any individual or organization listed in items 4 or 5 above? Yes ☒ No ☐ If yes, insert approximate amount of such sales $ not available at this time, purchases $ not available at this time, and attach explanations of how transfer prices were determined.
7. If your corporation has been involved in any reorganization during the period covered by this return, attach a detailed explanation.
8. Insert: Your Wisconsin employer identification number 32803 (If none, write none) Your Wisconsin seller's permit number 39561 - various (If none, write none) Your Wisconsin use tax number 39561 (If none, write none)
9. Did you purchase any taxable tangible personal property for storage, use or consumption in Wisconsin without payment of a state sales or use tax? Yes ☐ No ☒ If yes, a 5% Wisconsin Use Tax must be paid with an appropriate sales or use tax return.

Page 4

Schedule I — OTHER ORDINARY AND NECESSARY EXPENSES

Kind of Expense	Amount
Casualty Losses	22,711
Travel, Trade and moving	66,635
Installation & Removal	61,677
Credit & Collection	85,325
Sales Promotion	159,560
Products Consumed	17,541
Postage & Stationery Supplies	96,842
Outside Transportation	137,789
Fuel, Light & Power	151,861
Telephone & Telegraph	49,369
Outside Services	73,843
Administrative Expenses	116,666
Area Expenses	407,232
Misc. Marketing Expenses	18,887
Commissions	1,150,219
Painting	78,046
Total to line 21, page 1	2,694,203

Schedule X — U. S. INCOME TAXES

1. Paid in 1967 on 1966 income	
2. Paid in 1967 on 1967 income	
3. Additional assessments paid in 1967 on incomes of prior years	
4. Total	
5. Amount deductible (limited to 10% of line 23, page 1 — to line 24, page 1)	
6. Non-deductible portion (line 4 minus line 5 — to line 4, Schedule L)	None

TAX RATE SCHEDULE (See Instruction F)

If the net income is:	The amount of franchise or income tax is:
Not over $1,000	2% of net income
Over $1,000 but not over $2,000	$ 20 plus 2 1/2% of excess over $1,000
Over $2,000 but not over $3,000	$ 45 plus 3 % of excess over $2,000
Over $3,000 but not over $4,000	$ 75 plus 4 % of excess over $3,000
Over $4,000 but not over $5,000	$115 plus 5 % of excess over $4,000
Over $5,000 but not over $6,000	$165 plus 6 % of excess over $5,000
Over $6,000	$225 plus 7 % of excess over $6,000

Corporations reporting in excess of $6,000.00 net income may use a short cut method of tax computation by multiplying their net income by 7% and subtracting $195.00.

Corporations which can reasonably expect to have a tax liability of $2,000.00 or more are required to file a declaration of estimated tax and to prepay such estimated liability. (See instruction H of The Instruction Booklet.)

Schedule Z — DISTRICTS FROM WHICH INCOME IS DERIVED

THIS SCHEDULE MUST BE COMPLETED BY ALL CORPORATIONS WHICH DERIVE THEIR INCOME FROM MORE THAN ONE MUNICIPALITY

"Enter the legal name of each municipality, checking the proper city, village or town block, and the name of the appropriate county in which a portion of your income was derived. If your operation in each of the various municipalities listed was an integral part of a unitary business, the amount of property (net value, but include inventory), cost of manufacturing, and sales attributable to each municipality must be inserted in the proper column. If any factor for a particular municipality is zero, insert "none" in the column.

If the operation in each of the various municipalities listed was not an integral part of a unitary business, and if the net profit in each location can be accurately determined in accordance with Section 71.07, such net profit figure for each municipality may be submitted in the last column in lieu of the data required in the preceding three columns.

DISTRICT					AMOUNT			
Name	Check one			County	Property	Cost of Manufacturing	Sales	Net Profit
	City	Vil.	Town					
				Schedule	Z-1 Attached			
Totals								

DECLARATION

We, the undersigned, president (or vice-president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, each for himself declares that this return (including any accompanying schedules and statements) has been personally examined by him and is, to the best of his knowledge and belief, a true and correct report of income under the provisions of Chapter 71 of the Wisconsin Statutes.

Signature	Vice President Title	April 15, 1968 Date
Signature	Assistant Treasurer Title	April 15, 1968 Date
Individual or firm signature of preparer	Address	Date

EXHIBIT 11-7D

3022

Tracy 713-221-6928 #11-7D Bob 713-221-6405 Ex 72 KC

WISCONSIN CORPORATION FRANCHISE OR INCOME TAX RETURN FORM 4

FOR STATE, COUNTY AND MUNICIPAL REVENUES

1968 Ex 11-7D KC

or other income year: Beginning 10-2-74 Ending

Due the 15th day of the third month following the close of the income year. Mail to: WISCONSIN DEPARTMENT OF REVENUE, Corporation Taxation Section, Post Office Box 98, Madison, Wisconsin 53701

LEAVE BLANK: File No. 79-407273; Type SA; Form 4-ES 4 & 5; Late Fee ☐ Inv. Report Fee ☐

A. Name		B. State of Incorporation	C. Year of Incorporation	D. Bus. Code No.
HUMBLE OIL & REFINING COMPANY 713-221-3636		Delaware	1959	1310
E. Mailing Address: Street and Number	City	State		Zip Code
800 Bell Avenue	Houston	Texas		77002

F. If all your income is derived from within one municipality, complete blocks G and H. If your income is derived from more than one municipality, complete Schedule Z, page 4. G. City ☐ Village ☐ or Town ☐ of H. County of — Leave Blank: AAAA73

INCOME	1. Gross receipts or gross sales, less returns and allowances	$ 16,117,975
	2. Cost of goods sold (Schedule A) or cost of operations (attach schedule)	11,109,026
	3. Gross profit	5,008,949
	4. Gross dividends (Schedule B) — FIELD AUDITED	69,640
	5. Profits (losses) from disposal of capital assets (Schedule C)	734,109
	6. All other income (Schedule D)	5,812,698
	7. Total income from all sources	
DEDUCTIONS	8. Compensation of officers (Schedule E)	1,451,174
	9. Wages and bonuses	325,271
	10. Repairs	147,545
	11. Bad debts and other losses (Schedule F)	633,831
	12. Rents	670,168
	13. Taxes (Schedule G)	2,011
	14. Interest	37,908
	15. Depletion and amortization (attach schedule)	565,843
	16. Depreciation (Schedule H)	337,767
	17. Advertising	
	18. Pension, profit sharing, stock bonus, annuity plans	
	19. Other employee benefit plans	
	20. Deductible dividends received (Schedule B)	2,560,755
	21. Other ordinary and necessary expenses (Schedule I)	6,732,273
	22. Total (lines 8 through 21)	(919,575) Loss
	23. Subtotal (line 7 minus line 22)	(919,575) Loss
	24. U. S. income taxes (not in excess of 10% of line 23) (Schedule X)	
	25. Subtotal	(919,575) Loss
	26. Contributions (not in excess of 5% of line 25) (attach schedule)	
	27. Subtotal	(919,575) Loss
	28. Unused 1966 net business loss offset	
	29. 1967 net business loss offset	
	30. Net income	(919,575) Loss

APR 1969 RECEIVED WIS. DEPT. OF REVENUE Corp. Income Tax Bureau

CHECKED BY JTU

ADDITIONAL TAX REFUND

☐ ☐ ☒ Income Adjust. $ 4,532,155.

D O F Years 1965 thru 1967

O F I Additional Tax $ 316,470.85

O F E 6% Interest to 1-15-72 $ 77,375.21

M I L Del. Int. to $

A C D $

G E Amount Due $ 393,846.06

E IC-703 (R. 1-71)

ITING ON THE APPORTIONMENT METHOD (Form 4B)

Form 4B — Leave Blank

TAX		
38. Total tax (see instruction F)	-0-	
39. Less: Declaration installments paid (Form 4-ES)	-0-	
40. Other payments and credits		
41. Balance due — attach remittance	-0-	
42. Overpayment — complete line 43		
43. Enter amount of overpayment you want: credited on 1969 estimated tax $ ____ 44. Refunded $ ____		

0 1 2 3 4 5 6 7

MTT 45148 APR 22 69 .00 $

Page 2

Schedule A — COST OF GOODS SOLD (See Instruction 2)

1. Inventory at beginning of year (complete lines 9 and 10)	$ 464,304
2. Merchandise purchased for manufacturing	
3. Merchandise purchased for resale	10,939,189
4. Salaries and wages	
5. Cost of manufacturing (submit schedule)	
6. Total	11,403,493
7. Inventory at end of year	(294,467)
8. Cost of goods sold to line 2, page 1	11,109,026

9. Have you included Form 107 Yes ☐ No ☐ See General Instructions K-4

10. Has your method of inventory valuation changed? Yes ☐ No ☐ If yes, attach explanation.

Schedule B — DIVIDENDS (See Instruction 4)

Name of Declaring Corporation	Gross Dividends	Deductible Dividend Received
Gross dividend income to line 4, page 1	NONE	
Deductible dividends received to line 28, page 1		NONE

Schedule C — PROFITS (LOSSES) FROM DISPOSAL OF CAPITAL ASSETS (See Instruction 5)

Kind of Property	Sites: We.	Sites: Out-side	Cost or Other Basis	Depreciation Allowed or Allowable	Net Tax Cost	Gross Sales Price less Expense of Sale	Profit (Loss)
DETAILED RECORDS ARE MAINTAINED BY TAXPAYER AND ARE AVAILABLE FOR INSPECTION							
Total to line 6, page 1							

Schedule D — ALL OTHER INCOME (See Instruction 6)

1. Interest from obligations of the United States and its instrumentalities*	
2. Interest from State and Municipal obligations	
3. Interest from securities (except amounts required on lines 1 and 2)	
4. All other interest	$ 19,770
5. Rent	453,411
6. Royalties from tangible property	
7. Royalties from patents and intangible property	
8. Collections of accounts written off in previous years	
9. Tax refunds... State Gasoline Tax Allowance	82,250
...Sale of Heating Oil Business	176,001
...Other Income	2,677
Total to line 6, page 1	$ 734,109

*Interest from obligations of the United States and its instrumentalities is not taxable income for corporations subject to income tax. See introduction to instruction booklet.

3023

IC-042 Wisconsin Department of Revenue

Please refer to page 5 of Instruction Booklet IC-100

FORM 4A

NOTE: A copy of the balance sheet and related schedules submitted with your Form 1120 may be filed in lieu of Schedule J.

BALANCE SHEETS OF HUMBLE OIL & REFINING COMPANY
Name of Corporation

Schedule J	December 31, 1967 or other income year ending (A) Amount	December 31, 1967 or other income year ending (B) Total	December 31, 1968 or other income year ending (C) Amount	December 31, 1968 or other income year ending (D) Total
ASSETS				
1. Cash				
2. Trade notes and accounts receivable				
(a) Less allowance for bad debts				
3. Inventories				
4. Gov't obligations: (a) U.S. & instrumentalities				
(b) State, subdivisions thereof, etc.				
5. Other current assets (attach schedule)				
6. Loans to stockholders		SCHEDULE J-1 ATTACHED		
7. Mortgage and real estate loans				
8. Other investments (attach schedule)				
9. Buildings and other fixed depreciable assets				
(a) Less accumulated depreciation				
10. Depletable assets				
(a) Less accumulated depletion				
11. Land (net of any amortization)				
12. Intangible assets (amortizable only)				
(a) Less accumulated amortization				
13. Other assets (attach schedule)				
14. Total assets				
LIABILITIES AND CAPITAL				
15. Accounts payable				
16. Mtges., notes, bonds payable in less than 1 yr.				
17. Other current liabilities (complete schedule J-1)				
18. Loans from stockholders				
19. Mtges., notes, bonds payable in 1 yr. or more				
20. Other liabilities (complete schedule J-2)				
21. Capital stock: (a) Preferred stock				
(b) Common stock	(A)		(B)	
22. Paid-in or capital surplus (attach reconciliation)				
23. Retained earnings—Appropriated (attach sch.)				
24. Retained earnings—Unappropriated				
25. Less cost of treasury stock		( )		( )
26. Total liabilities and capital				

(A) and (B)—See lines 1 and 14, Schedule K

Schedule J-1 Other Current Liabilities

Title of Account	Account Balance: Beginning of Year	Account Balance: End of Year
Accrued State Franchise or Income Tax		
Accrued Federal Income Tax		
Accrued Local Property Tax		
Total Other Current Liabilities (line 17)		

Schedule J-2 Other Liabilities

Title of Account	Account Balance: Beginning of Year	Account Balance: End of Year
(Contingent or Surplus Reserves)		
Total Other Liabilities (line 20)		

Schedule K — **ANALYSIS OF RETAINED EARNINGS**

1. Balance at beginning of income year (must agree with item (A), line 24, Schedule J)		2,687,906,551
Amounts credited to retained earnings:		
2. Book income (see line 1, Schedule L)	606,668,035	
3. Other credits to retained earnings (itemize)		
4.		
5.		
6.		
7.		606,668,035
Subtotal		3,294,574,586
Amounts debited to retained earnings:		
8. Cash dividends (a) Preferred ... (date paid ... 19...)		
(b) Common ... (date paid ... 19...)	390,000,000	
9. Stock dividends ... (date paid ... 19...)		
10. Other debits to retained earnings (itemize)		
11. ....Interperiod Tax Allocation Adjustment	151,285,000	
12. ....Amortization of unoperated acreage adjustment	87,400,000	
13.		628,685,000
14. Balance at end of income year (must agree with item (B), line 24, Schedule J)		2,665,889,586

Schedule L — **RECONCILIATION OF BOOK INCOME WITH NET INCOME**

1. Book income (must agree with line 2, Schedule K)		
Add adjustments to arrive at net income:		
2. Premiums paid on corporate life insurance policies		
3. Unallowable contributions		
4. Non-deductible portion of U. S. income taxes paid (line 6, Schedule X)		
5. Athletic and social club dues		
6.		
7.		
8.		
9.		
10. ....SCHEDULE O COMPLETED IN		
11. ....LIEU OF SCHEDULE H		
12. Additions to surplus reserves charged against book income:		
(a) Wisconsin franchise and income tax		
(b) U. S. income tax		
(c)		
(d)		
(e)		
Subtotal		
Deduct adjustments to arrive at net income:		
13. Deductible dividends received (Schedule B)		
14. Non-taxable stock dividends received		
15. Net business loss offset (lines 28 and 29, page 1)		
16. Increase in cash value of life insurance		
17.		
18.		
19.		
20.		
21.		
22.		
23.		
24. Charges made on books against surplus reserves:		
(a) Wisconsin franchise and income tax		
(b) U. S. income tax		
(c)		
(d)		
(e)		
25. Net income (line 30, page 1, Form 4)		

3024

JC-044
Wisconsin Department of Revenue

Form 4C

IMPORTANT — REFER TO GENERAL INSTRUCTION J OF INSTRUCTION BOOKLET IC-100

Schedule N — 1968 SEPARATE ACCOUNTING DATA OF ... HUMBLE OIL & REFINING COMPANY
Name of corporation

INCOME	1. Wisconsin	2. Outside	3. Total
Gross Operating Revenue	$ 16,117,975	$ 3,956,148,379	$ 3,972,266,354
Cost of goods sold:			
Beginning Inventory	464,304	260,486,930	260,951,234
Purchases & Manufacturing Costs	10,939,189	2,737,337,735	2,748,276,924
Closing Inventory	(294,467)	(267,383,468)	(267,677,935)
Costs of Goods Sold	11,109,026	2,730,441,197	2,741,550,223
Gross Profit	5,008,949	1,225,707,182	1,230,716,131
Deduct:			
Marketing Expenses	6,416,946	409,339,715	415,756,661
Administrative Expenses	209,591	59,110,924	59,320,515
Total	6,626,537	468,450,639	475,077,176
Total income (Loss) From Operations	(1,617,588)	757,256,543	755,638,955
EXPENSES — Basis of Allocation			
Non-Operating Revenue:			
Royalties		76,989	76,989
Interest	19,770	3,764,131	3,783,901
Dividends		18,900,488	18,900,488
Rent Income	453,441	(453,441) *	
Other (Charges) & Credits			
Interest	(2,011)	(20,929,911)	(20,931,922)
Income Taxes	(167,674)	(151,682,016)	(151,849,690)
Other	315,555	733,759	1,049,314
Net Profit (Loss) Carried to Surplus	(998,507)	607,666,542	606,668,035
Total expenses			
Book income			

* The Rental income of Humble Oil & Refining Company outside Wisconsin has been netted against the Departmental Expenses. Since this is an item which can be clearly accounted for on a direct basis, we do not feel that it is necessary to go back and set out the "Outside Wisconsin" and the "Everywhere" amounts.

When Form 4C is used, Schedule O must be completed in place of Schedule L. The book income in column 3 must agree with line 2, Schedule K.

(over)

Schedule O RECONCILIATION OF BOOK INCOME WITH NET INCOME

	1. Wisconsin	2. Outside	3. Total
1. Book income (must agree with Schedule N)	$ (998,507)	$ 607,666,542	$ 606,668,035
Add adjustments to arrive at net income:			
2. Premiums paid on corporate life insurance policies			
3. Unallowable contributions			
4. Non-deductible portion of U. S. income taxes paid (line 6, Schedule X)			
5. Athletic and social club dues			
6 Depreciation Not Deductible	78,932		(78,932)
7.			
8.			
9.			
10.			
11.			
12. Additions to surplus reserves charged against book income:			
(a) Wisconsin franchise and income tax			
(b) U. S. income tax			
(c)			
(d)			
(e)			
Subtotal	$ (919,575)	*	$ 606,589,103
Deduct adjustments to arrive at net income:			
13. Deductible dividends received (Schedule B)			
14. Non-taxable stock dividends received			
15. Net business loss offset (lines 28 and 29, page 1)			
16. Increase in cash value of life insurance			
17.			
18.			
19.			
20.			
21.			
22.			
23.			
24. Charges made on books against surplus reserves:			
(a) Wisconsin franchise and income tax			
(b) U. S. income tax			
(c)			
(d)			
(e)			
Subtotal			
25. Net income (line 30, page 1) (Loss)	$ (919,575)		
26. Net income (Outside and Total)		$ 607,666,542	$ 606,589,103

CHECKED BY JTU COMPUTER

27. Were any products or supplies transferred between Wisconsin branches and branches outside Wisconsin? Yes [X] No [ ]

Not available Not available

If yes, insert the approximate amount of transfers into Wisconsin $ at this time and out of Wisconsin $ at this time

and attach explanation of how transfer prices were determined.

28. Explain bases used to allocate expenses within and without Wisconsin Expenses deducted are actually incurred in Wisconsin with the exception of overhead which is allocated on the basis of sales.

3625

HUMBLE OIL & REFINING COMPANY
800 BELL AVENUE, HOUSTON, TEXAS 77002

1968 WISCONSIN CORPORATION FRANCHISE OR INCOME TAX RETURN

Schedule J-1 - Comparative Balance Sheet

ASSETS	January 1, 1968	December 31, 1968
Cash	$ 52,633,353	$ 55,155,995
Notes and Accounts Receivable	$ 634,979,461	$ 664,951,123
Reserve	15,943,099	19,850,689
	619,036,362	645,100,434
Inventories	283,610,662	292,598,334
	$ 226,849,695	$ 286,708,236
Investments	3,272,096	2,796,221
	223,577,599	283,912,015
Contracts, Trademarks and Other Intangible Assets	$ 7,737,075	$ 7,229,598
Reserve	4,805,562	$ 5,121,757
	2,931,513	2,107,841
Fixed Assets	$5,869,578,562	$6,384,181,607
Reserves	2,632,968,493	2,778,976,854
	3,236,610,069	3,605,204,753
Special Deposits and Funds	$ 2,891,252	$ 3,470,563
Reserve	4,886	4,886
	2,886,366	3,465,677
Prepaid and Deferred Charges	33,311,075	35,838,827
TOTAL ASSETS	$4,454,596,999	$4,923,383,876

LIABILITIES AND CAPITAL		
Accounts Payable		$ 662,583,103
Bonds, Notes and Mortgages Payable	$ 346,535,293	23,509,659
Annuities Payable to Employees (Liability Determined by Actuarial Study)	41,250,694	31,433,019
	30,597,807	
Accrued Expenses:		
Government Income Taxes	$ 115,619,994	$ 142,837,146
Other Taxes, Interest, Insurance, Etc.	94,247,032	105,265,018
Salaries and Wages	13,144,378	11,136,330
Vacation Pay	21,152,384	22,140,657
	244,163,788	281,379,151
Deferred Credits	81,927,083	238,595,367
Other Liabilities	19,446,253	17,224,461
Capital Stock	773,604,647	773,604,647
Capital Surplus	229,164,883	229,164,883
Earned Surplus	2,687,906,551	2,665,889,586
TOTAL LIABILITIES AND CAPITAL	$4,454,596,999	$4,923,383,876

CHECKED BY JTU COMPUTER

3026

HUMBLE OIL & REFINING COMPANY
800 BELL AVENUE, HOUSTON, TEXAS 77002

A. Corporations of Which Taxpayer Owned Over 50 Percent of Voting Stock at December 31, 1968:

Name	Address	Percentage Owned	Date Acquired
Carter Oil Company, The	800 Bell Avenue, Houston, Texas 77002	100.00	1959
Esso, Incorporated	60 West 49th Street, New York, New York 10020	100.00	1959
Esso Production Research Company	3120 Buffalo Speedway, Houston, Texas 77006	100.00	1964
Friendswood Development Company	800 Bell Avenue, Houston, Texas 77002	100.00	1962
Caseteria Corporation	800 Bell Avenue, Houston, Texas 77002	100.00	1960
General Automatic, Inc.	900 First Nat'l Bank Bldg., Baltimore, Maryland 21203	100.00*	1960
Humble Communications Company	800 Bell Avenue, Houston, Texas 77002	100.00	1961
Humble Gas Transmission Company	1700 Commerce Bldg., New Orleans, Louisiana 70112	100.00	1962
Humble Leasing Company	800 Bell Avenue, Houston, Texas 77002	100.00	1966
Humble Pipe Line Company	800 Bell Avenue, Houston, Texas 77002	100.00	1961
Humble Transportation Company	800 Bell Avenue, Houston, Texas 77002	100.00	1968
Humble Travel Club, Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1964
Monterey Oil, Gas & Transmission Co.	821 Gravier Street, New Orleans, Louisiana 70160	100.00	1961
Oklahoma Oil Company	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Pate Oil Company	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Penola Oil Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Petroleum Casualty Company	800 Bell Avenue, Houston, Texas 77002	100.00	1960
Petroleum Heat and Power Company	800 Bell Avenue, Houston, Texas 77002	100.00	1964
Prince George Fuel Corporation, The	900 First Nat'l Bank Bldg., Baltimore, Maryland 21203	100.00*	1960
Red Bluff Development Company	800 Bell Avenue, Houston, Texas 77002	100.00	1962
Solar-Therm Corporation of America	800 Bell Avenue, Houston, Texas 77002	100.00	1965
Standard Oil Company, Inc.	800 Bell Avenue, Houston, Texas 77002	100.00	1960
			1960

*No Stock Issued

B. Corporation Owning 50 Percent or More of Taxpayer's Voting Stock:

Name	Address	Percentage Owned	Date Acquired
Standard Oil Company (New Jersey)	30 Rockefeller Plaza, New York, New York 10020	100.00	1959

3027

IC-830

State of Wisconsin \ DEPARTMENT OF REVENUE

INCOME, SALES AND EXCISE TAX DIVISION
CORPORATION TAXATION SECTION
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

February 26, 1969

Re: 99-40723

Humble Oil & Refining Company
P. O. Box 2180
Houston, Texas 77001

Attention: R. F. Haidner, Jr.
In regard to:
Your letter of: February 17, 1969

We have received your request for an extension of time in which to file:

☒ A 1968 Wisconsin corporation franchise or income tax return, Form 4.

☐ A complete 1968 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1968 return filed? Yes☐ No☐

☐ A 1968 Inventory report Form 10.

An extension of time to April 15, 1969 is hereby granted for the filing of your return (s) as indicated.

TAX RETURN - FORM 4

The maximum extension permitted by Section 71.10 (5) of the Wisconsin Statutes is 30 days, and your return will be considered timely filed if it is received on or before the date shown above. If no return is filed by that time the statutory $10.00 late filing fee will be assessed.

INVENTORY REPORT - FORM 10

This 30 day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

TAX PAYMENT

Any corporation franchise or income tax that is computed to be due on the complete return which was not paid by the original due date will be subject to extension interest at the rate of 5% per annum from the original due date to the end of the extension period, or the date of payment whichever is earlier. Any amount of tax computed to be due on the complete return that is not paid by the end of the extension period will be considered delinquent as of that date and will be subject to a 2% delinquent penalty and delinquent interest will be added at the rate of 1% per month from the date of delinquency until the date of payment.

ADDITIONAL TIME TO FILE THE COMPLETE FORM 4

If it is impossible to file a complete Form 4 within the extension period granted, a tentative return should be filed prior to the expiration of the extension period, and the complete return filed within 60 days after the close of the extension period. If the tentative return is filed within the extension period and the complete return is filed more than 60 days after the close of the extension period the 25% negligence penalty may be imposed unless it can be shown that the delayed filing was due to reasonable cause and not to negligence. Complete returns filed more than 60 days after the close of the extension period should contain a statement explaining the reason for the delayed filing.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

NOTE: Enclose one copy of this notice with your return.

3628

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
W. TRENT TURPIN
COORDINATOR
TAX COMPLIANCE
SAM FARRELL
SUPERVISOR
PRODUCTION TAXES
SALES AND USE TAXES

December 18, 1968

POST OFFICE BOX 2180

99-40723

RECEIVED
DEC 23 1968
WIS. DEPT. OF REVENUE
CORPORATION FRANCHISE
& INCOME TAX BUREAU

Info Letters
Extension

Wisconsin Department of Revenue
Corporation Taxation Section
P. O. Box 98
Madison, Wisconsin 53701

Gentlemen:

Because of the large number of tax returns, statements and reports that Humble Oil & Refining Company is required to file at the end of 1968, it is doubtful that we will be able to prepare Forms 9B and 9X, Information Returns, in time to remit them by the January 31, 1969 deadline.

The preparation of these forms cannot begin until 1968 payments have been recorded, which is usually a few weeks after the end of the year. Consequently, we should like to request an extension of time until March 15, 1969, in which to file Forms 9B and 9X. Your favorable reply will be greatly appreciated.

Very truly yours,

Sam Farrell
Sam Farrell

MAH/csb

3629

December 26, 1968

Re: 99-40723

Humble Oil & Refining Company
P. O. Box 2180
Houston, Texas 77001

ATTENTION: SAM FARRELL

Dear Sir:

We have received your request of December 18, 1968 for an extension of time in which to file your 1968 Wisconsin information returns Forms 9B and 9X.

The Wisconsin Statutes do not expressly grant this office authority to grant extensions of time for filing these reports.

However, if the required information returns, Forms 9B and 9X are received in this office by March 15, 1969 these reports shall be accepted as filed and no penalty shall be imposed.

By_____
Kenneth F. Kleinschmidt

KFK:emj

3030

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
W. TRENT TURPIN
COORDINATOR
TAX COMPLIANCE
R. F. HEIDNER, JR.
SUPERVISOR
INCOME AND FRANCHISE TAXES

POST OFFICE BOX 2180

February 17, 1969

99-40723
Col

Wisconsin Department of Revenue
Corporation Taxation Section
P. O. Box 98
Madison, Wisconsin 53701

Gentlemen:

This Company respectfully requests an extension to April 15, 1969 for filing the Wisconsin Corporation Franchise or Income Tax Return which is due March 15, 1969.

In order to properly file the return certain pertinent information must be obtained from regional and divisional offices and consolidated in this office. The information will not be available by the due date to file a complete return.

Your favorable consideration of this request will be greatly appreciated.

Yours very truly,

R F Heidner Jr

R. F. Heidner, Jr.

BTM/sm

IC-830

3031

State of Wisconsin \ DEPARTMENT OF REVENUE

INCOME, SALES AND EXCISE TAX DIVISION
CORPORATION TAXATION SECTION
POST OFFICE BOX 98
MADISON, WISCONSIN 53701

February 26, 1969

Re: 99-40723

Humble Oil & Refining Company
P. O. Box 2180
Houston, Texas 77001

Attention: R. F. Heidner, Jr.
In regard to:
Your letter of: February 17, 1969

We have received your request for an extension of time in which to file:

[X] A 1968 Wisconsin corporation franchise or income tax return, Form 4.

[ ] A complete 1968 Wisconsin corporation franchise or income tax return, Form 4.

Tentative 1968 return filed? Yes[ ] No[ ]

[ ] A 1968 Inventory report Form 10.

An extension of time to April 15, 1969 is hereby granted for the filing of your return (s) as indicated.

TAX RETURN - FORM 4

The maximum extension permitted by Section 71.10 (5) of the Wisconsin Statutes is 30 days, and your return will be considered timely filed if it is received on or before the date shown above. If no return is filed by that time the statutory $10.00 late filing fee will be assessed.

INVENTORY REPORT - FORM 10

This 30 day extension also applies to the Form 10, if such inventory report is required. A $10.00 late filing fee will be assessed if no Form 10 is filed prior to the extended due date listed above.

TAX PAYMENT

Any corporation franchise or income tax that is computed to be due on the complete return which was not paid by the original due date will be subject to extension interest at the rate of 5% per annum from the original due date to the end of the extension period, or the date of payment whichever is earlier. Any amount of tax computed to be due on the complete return that is not paid by the end of the extension period will be considered delinquent as of that date and will be subject to a 2% delinquent penalty and delinquent interest will be added at the rate of 1% per month from the date of delinquency until the date of payment.

ADDITIONAL TIME TO FILE THE COMPLETE FORM 4

If it is impossible to file a complete Form 4 within the extension period granted, a tentative return should be filed prior to the expiration of the extension period, and the complete return filed within 60 days after the close of the extension period. If the tentative return is filed within the extension period and the complete return is filed more than 60 days after the close of the extension period the 25% negligence penalty may be imposed unless it can be shown that the delayed filing was due to reasonable cause and not to negligence. Complete returns filed more than 60 days after the close of the extension period should contain a statement explaining the reason for the delayed filing.

By Kenneth F. Kleinschmidt
Kenneth F. Kleinschmidt

NOTE: Enclose one copy of this notice with your return.

65 [illegible]-70

3032

HUMBLE OIL & REFINING COMPANY

HOUSTON, TEXAS 77001

TAX DEPARTMENT
W. TRENT TURPIN
COORDINATOR
TAX COMPLIANCE
TROY W. BEHRINGER
SUPERVISOR
INCOME AND FRANCHISE TAXES

POST OFFICE BOX 2180

April 15, 1969

221-6988

APR 1969
RECEIVED
WIS. DEPT. OF
REVENUE
Corp. Franchise
& Income Tax
BUREAU

Wisconsin Department of Taxation
Corporation Franchise & Income Section
P. O. Box 98
Madison, Wisconsin 53701

Gentlemen:

Enclosed is Humble Oil & Refining Company's 1968 Wisconsin Corporation Franchise or Income Tax Return, reflecting a net loss of $919,575 from Wisconsin operations during the calendar year 1968. Also enclosed is your letter granting us an extension of time until April 15, 1969, within which to file the return. We appreciate very much your cooperation in granting us this extension of time to file our final return.

Yours very truly,

Troy Behringer

Troy Behringer Called 10-24-69

RET/est

Enclosures

Sheraton Lincoln
Hotel America
Savoy Fields

Start Feb 2, 1970

3033
99-40723

Humble Oil & Refining Co.
WISCONSIN DEPARTMENT OF TAXATION
OFFICE OF
SUPERVISOR OF ASSESSMENTS
Room 580 STATE OFFICE BUILDING
819 N. 6th Street
Milwaukee, Wisconsin 53203
PHONE: 224-4455

Please Return This Letter As Soon As Possible

Sales Card No. R 1125 Milwaukee, Wis., AUG 26 1968

Kenneth E. Monroe
7232 - 50th Avenue
Kenosha, Wisconsin 53140

SECOND REQUEST
WE BELIEVE THE MOST VALID INFORMATION CAN BE OBTAINED FROM THE PARTIES BUYING OR SELLING THE PROPERTY LISTED.
WITHOUT YOUR ASSISTANCE WE ARE REQUIRED TO OBTAIN THE INFORMATION FROM OTHER SOURCES WHICH MAY NOT BE AS ACCURATE AND ALSO MORE EXPENSIVE
YOUR COOPERATION WILL BE APPRECIATED.
YOURS VERY TRULY,
ROBERT E. WOOD, SUPV. OF ASSMT.

The records in the office of the Register of Deeds of the County of Racine show that you bought xxxxxx certain property from xx Humble Oil & Refining Co. as follows:

Douglas Ave. Park Addn.
Lot 8
Pt of SE¼ Sec 5-3-23

Which is triangular piece of land directly S of Douglas Ave Park Addn - bounded on E by Charles St. & W By Douglas Ave.

The Wisconsin Department of Taxation, under Section 68.04, is charged with the duty of collecting statistics of recorded sales of real estate, and under Section 73.03 (8), has the power to require individuals, partnerships, associations and corporations to furnish information concerning their capital, funded or other debt, current assets and facts which may be needful to enable the department to ascertain the value and the relative burdens borne by all kinds of property in the state.

One of the principal duties in this connection is the determination of the full value of the property of the state and the respective counties thereof. Your cooperation in supplying the information listed below will be of material assistance to us in equalizing the distribution of State and County Taxes.

WISCONSIN DEPARTMENT OF TAXATION.

1. Was it an actual Sale? ✓ Year of Sale? 68 Total Selling Price? 25,000 co
2. If not a sale, was it a trade? _____ Address of property traded _____ Value of property traded $ _____
   If not a sale nor a trade, was it a Gift? _____ Inheritance? _____ Collateral? _____
3. If above price included personal property, what was its value? No
4. Are buyer and seller related? No If so, what relation? _____
5. Was this transaction made to avoid a Foreclosure? No To Correct Title? No
6. Was this a Land Contract? No Land Contract ran from _____ YEAR to _____ YEAR
7. Was the property conveyed Farm? No Residential? No Mercantile? Yes
   Manufacturing? _____ Lake Shore? _____ Other? _____
8. If Farm property, how many acres tillable land? _____ Pasture? _____ Wood? _____
   Marsh? _____ Other? _____

8/24/68 (DATE) Phillip H. Richards (SIGN HERE)

Additional information may be given on back of this sheet.

TO: [illegible] Section FROM: Ronald J. Mogensen

The sales & use tax returns of

Humble Oil & Refining Company

for the period 1965 to 1968

have been examined in field audit.

It has been recommended by the auditor that the returns covered in this examination be accepted as filed. The taxpayer has been notified of the auditor's recommendation and no adjustments have been made to the returns indicated above.

A. 708

3034

[illegible]

TO: [illegible] Section FROM: Ronald J. Mogensen

The Withholding tax returns of

Humble Oil & Refining Company

for the period 1965 to 1968

have been examined in field audit.

It has been recommended by the auditor that the returns covered in this examination be accepted as filed. The taxpayer has been notified of the auditor's recommendation and no adjustments have been made to the returns indicated above.

A. 709

3035

[illegible]

A. 710

3036

FIELD AUDIT CHANGE & DISPOSITION REPORT
(Instructions for the use of this form are given in AD 545 1.1)

I. AUDITOR'S REPORT

(1) Taxpayer's Name: Humble Oil & Refining Co.
(2) Identification Number: 99-40723
(3) Auditor's Number: 518
(4) Tax District: APPN-00
(5) Occupation Code: 1310
(6) Number of Years: 4 Audited; 4 Assessed
(7) Type of Tax: 1. Income; 2. Gift; (3) Corporation Franchise/Income; 4. Sales/Use; 5. Withholding
(8) Source: 1. Central Audit; 2. Central Compliance; 3. District Office; 4. Fiduciary/Gift; 5. Refund Request; 6. Federal Abstract; 7. Non-filer; (8) Corporation; 9. Self-initiated; _____ Special Project
(9) Average Reported Wisconsin Total Income for Years Audited: (1) Under $2,000; 2. $ 2,000 - $ 4,999; 3. $ 5,000 - $ 6,999; 4. $ 7,000 - $ 8,999; 5. $ 9,000 - $10,999; 6. $11,000 - $12,999; 7. $13,000 - $14,999; 8. $15,000 - $19,999; 9. Over $20,000
(10) Kind: 1. Individual; 2. Partnership; (3) Corporation; 4. Estate; 5. Trust
(11) Method: (1) Specific; 2. Net Worth; 3. Bank Deposit; 4. Doomage; 5. Other

II. AUDITOR'S ADJUSTMENTS

Business, Profession, or Farm Income: 01 Gross sales; 02 Merchandise purchased; 03 Inventories; 04 Salaries, wages, and labor; 05 Materials and supplies; 06 Depreciation; 07 Taxes; 08 Rent expense; 09 Repairs expense - capitalized; 10 Insurance expense; 11 Legal and professional fees; 12 Commissions expense; 13 Retirement plan; 14 Interest expense; 15 Bad debts; 16 Travel; 17 Advertising; 18 Dues

Wages and Other Income: 20 Wages, salaries, and tips; 21 Interest income; 22 Dividend income; 23 Pensions and annuities; 24 Partnership; 25 Estate or trust; 26 Rent income; 27 Commissions; 28 Sale or exchange of property

Itemized Deductions: 30 Business expense (Employee); 31 Medical/Dental expense; 32 Contributions; 33 Tax deductions; 34 Interest expense; 35 Misc. itemized deductions

Miscellaneous: 40 Capital gains deduction; 41 Out-of-state income or loss; 42 Allocation between husband/wife; 43 Capital loss carry over; 44 Operating or business loss; 45 Other add modifications; 46 Other subtract modifications; 47 Transitional adjustments; 48 Withholding or declaration credit; 49 Personal exemptions; 51 Change method of accounting

Sales Tax: 60 Gross receipts; 61 Non-taxable sales; 62 Sales for resale; 63 Ex-tax purchase subject to use tax; 64 Sales outside Wisconsin

Corporation Tax: 70 Non-apportionable income; 71 Apport. factor: Sales; 72 Apport. factor: Manufacturing; 73 Apport. factor: Property; (74) Separate acctg. to apport.; 75 Apport. to separate acctg.; 76 Apport.: Wrong divisor used; 77 Substitute new apport. factors; 78 Deconsolidation

III. CHIEF AUDITOR'S REPORT

(1) Assessment Date: 0671
(2) Audit Days: 32
(3) Income Changed: 4532155
(4) Action: (1) Assessment; 2 Refund; 3 No change; 4 Refund reduced
(5) Assessment Notice:
Tax 316471
Interest
25% Penalty
Fraud Penalty
Total 316471

IV. DISPOSITION REPORT
(complete in red pen/pencil)

(1) Disposition Date: 1271
(2) Additional Audit Days:
(3) Disposition: 1 Paid or refunded per notice; (2) Appealed - Denied; 3 Appealed - Granted; 4 Appealed - Granted in part
(4) Disposition Amount:
Tax 316,471.
Interest 77,375.
25% Penalty
Fraud Penalty
Total 393,846.
(5) Years Finally Assessed 4

RECEIVED
MAY 4 1971
WIS. DEPT. OF REVENUE
CORPORATION FRANCHISE
& INCOME TAX BUREAU

A-718 (R. 2-69) 3036

A. 711

3037

AGREEMENT EXTENDING PERIOD FOR ASSESSMENT AND CORRECTION OF ASSESSMENT

Pursuant to the provisions of Section 71.11 (21) (d) of the Wisconsin Statutes:

IT IS HEREBY AGREED by and between Humble Oil & Refining Company, a Delaware corporation, and the Wisconsin Department of Revenue that the periods provided for in Section 71.11 (21) of the Wisconsin Statutes, within which the Wisconsin Department of Revenue may give notice of additional assessment or correction of assessment of the ~~[illegible]~~ franchise tax payment of Humble Oil & Refining Company for the fiscal (or calendar) year January 1, 1965 to December 31, 1965, both inclusive, are hereby extended to and including December 31, 1970.

IN WITNESS WHEREOF the parties hereto have voluntarily caused this agreement to be executed by their duly authorized officers and/or representatives this 25th day of February, 1970.

HUMBLE OIL & REFINING COMPANY

By _____
Vice-President

By _____
Assistant Secretary

(Corporate Seal)

WISCONSIN DEPARTMENT OF REVENUE

By _____
C. J. Hoel, Chief
Corporation Taxation Section

IC-218

A. 712

3038

March 3, 1970

Re: 99-40723

Humble Oil & Refining Co.
800 Bell Avenue
Houston, Texas

ATTENTION: TROY BERINGHER,
TAX DEPARTMENT

Gentlemen:

Enclosed is the executed copy of an agreement extending to December 31, 1970 the period of time within which we may correct your franchise tax assessment for the year 1965.

Thank you for your cooperation in this matter.

By_____
Ronald J. Mogensen, Audit Reviewer

RJM:jsk

Enclosure

cc: Mr. Thomas J. Sheridan

A. 713

3039

AGREEMENT EXTENDING PERIOD FOR ASSESSMENT AND CORRECTION OF ASSESSMENT

Pursuant to the provisions of Section 71.11 (21) (d) of the Wisconsin Statutes:

IT IS HEREBY AGREED by and between HUMBLE OIL & REFINING COMPANY, a Delaware corporation, and the Wisconsin Department of Revenue that the periods provided for in Section 71.11 (21) of the Wisconsin Statutes, within which the Wisconsin Department of Revenue may give notice of additional assessment or correction of assessment of the income and/or franchise tax payment of HUMBLE OIL & REFINING COMPANY for the fiscal (or calendar) year January 1, 1965 to December 31, 1966, both inclusive, are hereby extended to and including June 30, 1971.

IN WITNESS WHEREOF the parties hereto have voluntarily caused this agreement to be executed by their duly authorized officers and/or representatives this 20th day of November, 1970.

HUMBLE OIL & REFINING COMPANY

By _____
Vice President

By _____
Assistant Secretary or Treasurer

JWB

(Corporate Seal)

WISCONSIN DEPARTMENT OF REVENUE

By _____
C. J. Hoel, Chief
Corporation Taxation Section

IC-218

3040

December 3, 1970

Ref. 99-40723

Humble Oil & Refining Co.
Post Office Box 2180
Houston, Texas 77001

ATTENTION: MR. TROY W. BEHRINGER,
SUPERVISOR INCOME AND FRANCHISE TAXES

Gentlemen:

Enclosed is the executed copy of an agreement further extending to June 30, 1971 the period of time within which we may correct your franchise tax assessments for the years 1965 and 1966.

Thank you for your continued cooperation in this matter.

By_____
Ronald J. Mogensen, Audit Reviewer

RJM:jsk

Enclosure

cc: Mr. Thomas J. Sheridan

3041

HUMBLE OIL & REFINING COMPANY
P. O. BOX 2180
HOUSTON, TEXAS 77001

CERTIFIED MAIL
RETURN RECEIPT REQUESTED
22969

VIA AIR MAIL

Department of Taxation
Corporation Taxation Section
State of Wisconsin
P. O. Box 98
Madison, Wisconsin 53701

3042

August 18, 1971

Re: 99-40723

Humble Oil & Refining Company
Post Office Box 2180
Houston, Texas 77001

ATTENTION: ROGER BONNEY
Chief Tax Attorney

Gentlemen:

Receipt is acknowledged of the application for abatement filed in this office on July 26, 1971 in regard to our notice of additional assessment dated June 25, 1971. You will be notified within the near future of an informal conference date in regard to this matter.

By _____
Conrad A. Oleson, Conferee

CAO:kml

cc: Mr. Thomas J. Sheridan

3043

HUMBLE OIL & REFINING COMPANY
POST OFFICE BOX 2180 • HOUSTON, TEXAS 77001

TAX DEPARTMENT

ROGER BONNEY
CHIEF TAX ATTORNEY

RICHARD H. ADAMS
NEVILLE C. FITCH
JOHN J. HOLLIS
R. BRUCE MARSH
D. DANIEL PORRAS
ROBERT G. STANDLEE
H. C. TANNEHILL
ATTORNEYS

October 8, 1971

RECEIVED
OCT 12 1971
WIS. DEPT. OF REVENUE
CORPORATION FRANCHISE
& INCOME TAX BUREAU

Department of Revenue
State of Wisconsin
Madison, Wisconsin

Attention: Mr. C. J. Hoel

Re: 99-40723
Humble Oil & Refining Company

Gentlemen:

This is to advise you that October 26, 1971, is acceptable as the date for an informal conference on the above-captioned matter.

Yours very truly,

John J. Hollis

JJH:bmd

3044

Page 3

Schedule E — COMPENSATION OF OFFICERS (See Instruction 8)

Name	Resident of What State?	Official Title	Per cent of Stock Owned Common	Per cent of Stock Owned Preferred	Amount of Compensation
Subtotal					
Less amount claimed in Schedule A					
Total to line 8, page 1					

Schedule F — BAD DEBTS AND OTHER LOSSES* (See Instruction 11)

Kind of Loss	Amount
Bad Debts Charged Off	$ 147,545
Total to line 11, page 1	147,545

*Savings and Loan Associations, Mutual Savings Banks, Production Credit Associations and Credit Unions, see instruction 11.

Schedule G — TAXES (See Instruction 13)

Kind of Tax	Date Paid Month	Date Paid Year	Amount
1. Wisconsin franchise and/or income: a. Paid in 1968 on 1967 income (60-64)	3	68	$ 167,674
b. Paid in 1968 on 1967 income			
2. Real estate			367,101
3. ~~Xxxxxxxxxx~~ Permits			6,490
Federal & State			
Employer Taxes			127,441
Other			1,462
Subtotal			670,168
Less amount claimed in Schedule A			
Total to line 13, page 1			670,168

Schedule H — DEPRECIATION (See Instruction 18)

Character of Property	Rate (%) or Life	Amount of Depreciation 1968	Amount of Depreciation Accumulated Depreciation Allowed in Prior Years	Analysis of Asset Account Balance Beginning of Year	Additions During Year	Assets Written Off During Year	Balance End of Year
			← Total additional first-year depreciation (do not include in items below)				
Buildings							
Furniture and Fixtures							
Transportation Equip.							
Machinery and other Equip.							
Other (Specify)							
Totals							
Less amount claimed in Schedule A — Amount to line 18, page 1							

SCHEDULES SUPPORTING DEDUCTIONS ARE VOLUMINOUS BUT ARE AVAILABLE FOR INSPECTION

1. Location of books and records for audit purposes: 800 Bell Avenue (Street and Number) Houston (City) Texas (State)
2. Method of filing — see General Instruction D. Cash ☐ Accrual ☒
3. (a) Principal Business Activity Marketing Petroleum Prods. (b) Principal Product or Service Petroleum Products (See General Instruction C and complete Block D, Page 1.)
4. (a) Attach list of corporations in which you own, directly or indirectly, 50% or more of the outstanding voting stock.
   (b) Have the incomes of these affiliated corporations been included in this return? Yes ☐ No ☒
5. (a) Give the names of any corporations, individuals, partnerships, trusts or associations which own 50% or more of your outstanding voting stock Standard Oil Company (New Jersey)
   (b) Have the incomes of any of these organizations been included in this return? Yes ☐ No ☒
6. Did you sell to, or buy from, any individual or organization listed in items 4 or 5 above? Yes ☒ No ☐ If yes, insert approximate amount of such sales Not available at this time, purchases Not available at this time, and attach explanations of how transfer prices were determined.
7. If your corporation has been involved in any reorganization during the period covered by this return, attach a detailed explanation.
8. Insert: Your Wisconsin employer identification number 32803 (If none, write none) Your Wisconsin seller's permit number 39561-various (If none, write none) Your FEIN number 39561
9. Did you purchase any taxable tangible personal property for storage, use or consumption in Wisconsin without payment of a state sales or use tax? Yes ☐ No ☒ If yes, a 3% Wisconsin Use Tax must be paid with an appropriate sales or use tax return.

Page 4

Schedule I — OTHER ORDINARY AND NECESSARY EXPENSES

Kind of Expense	Amount
Casualty Losses	$ 21,549
Travel, Trade & Moving	75,110
Installation & Removal	48,188
Credits & Collection	101,944
Sales Promotion	127,031
Products Consumed	3,318
Postage & Stationery Supplies	70,578
Outside Transportation	10,737
Fuel, Light & Power	132,094
Telephone & Telegraph	40,677
Outside Services	71,033
Administrative Expenses	209,591
Area Expenses	531,778
Misc. Marketing Expenses	40,541
Commissions	1,025,300
Painting	50,826
Appraisals	460
Total to line 21, page 1	2,560,755.

Schedule X — U. S. INCOME TAXES

1. Paid in 1968 on 1967 income	
2. Paid in 1968 on 1968 income	
3. Additional assessments paid in 1968 on incomes of prior years	
4. Total	
5. Amount deductible (limited to 10% of line 23, page 1 — to line 24, page 1)	NONE
6. Non-deductible portion (line 4 minus line 5 — to line 4, Schedule L)	NONE

TAX RATE SCHEDULE (See Instruction F)

If the net income is:	The amount of franchise or income tax is:
Not over $1,000	2% of net income
Over $1,000 but not over $2,000	$ 20 plus 2 1/2% of excess over $1,000
Over $2,000 but not over $3,000	$ 45 plus 3 % of excess over $2,000
Over $3,000 but not over $4,000	$ 75 plus 4 % of excess over $3,000
Over $4,000 but not over $5,000	$115 plus 5 % of excess over $4,000
Over $5,000 but not over $6,000	$165 plus 6 % of excess over $5,000
Over $6,000	$225 plus 7 % of excess over $6,000

Corporations reporting in excess of $5,000.00 net income may use a short cut method of tax computation by multiplying their net income by 7% and subtracting $195.00.

Corporations which can reasonably expect to have a tax liability of $2,000.00 or more are required to file a declaration of estimated tax and to prepay such estimated liability. (See instruction H of The Instruction Booklet.)

Schedule Z — DISTRICTS FROM WHICH INCOME IS DERIVED

THIS SCHEDULE MUST BE COMPLETED BY ALL CORPORATIONS WHICH DERIVE THEIR INCOME FROM MORE THAN ONE MUNICIPALITY

Enter the legal name of each municipality, checking the proper city, village or town block, and the name of the appropriate county in which a portion of your income was derived. If your operation in each of the various municipalities listed was an integral part of a unitary business, the amount of property (net value, but include inventory), cost of manufacturing, and sales attributable to each municipality must be inserted in the proper column. If any factor for a particular municipality is zero, insert "none" in the column.

If the operation in each of the various municipalities listed was not an integral part of a unitary business, and if the net profit in each location can be accurately determined in accordance with Section 71.07, such net profit figure for each municipality may be submitted in the last column in lieu of the data required in the preceding three columns.

DISTRICT Name	Check one City	Vil.	Town	County	AMOUNT Property	Cost of Manufacturing	Sales	Net Profit
Totals								

DECLARATION

I, the undersigned president, vice president, treasurer, assistant treasurer, chief accounting officer or other duly authorized officer of the corporation for which this return was made, have personally examined this return, (including any accompanying schedules and statements) and declare that it is to the best of my knowledge and belief, a true and correct report of income under the provisions of Chapter 71 of the Wisconsin Statutes.

R. F. Lundaen — Signature

Assistant Secretary — Title

APR 15 1969 — Date

Individual or firm signature of preparer — Address — Date

EXHIBIT 11-11

Ex. 11 KC

AUDITING OIL COMPANIES

KURT KASPAR, JR.
RALPH PAUL

The oil industry as we know it today did not develop until the twentieth century, even though the first well in the United States was drilled in 1859. In a relatively short span of time it has grown into one of the world's largest industries, and its products have become the life blood of our complex industrial world.

The activities of major fully integrated oil companies are many and varied. The operations of these companies range from the search for likely crude oil and natural gas producing areas to the ultimate marketing of products developed from the oil and gas found in such areas. Between these extremes the following activities are necessary: The obtaining of drilling and producing rights, production of crude oil and natural gas, transportation and storage, refining of crude oil into its many components or the drying of gas too wet to sell in its natural state, and pipeline systems for the movement of finished products throughout the country.

Although each of the above activities is very different from the others, it may be stated that, in general, the major oil companies do not separate these activities along corporate lines, but rather by departments, each of which is headed by a vice-president. In some cases, however, the exploration and producing activities are incorporated separately from the storage, refining and marketing operations. Separation at this point is convenient and practical because of the readily determinable market price of crude oil at the well-head; that is, at the point where crude oil first reaches the surface of the earth. All crude oil produced in an area has a value equal to the "posted field price", which is the announced price currently paid by purchasers at the well-head in a specified production area. These posted field prices are circulated by all large buyers

and are bona fide competitive prices, not subject to manipulation or rigging and are effectively policed by state regulatory agencies. The posted field price controls what a company receives for its own production sold to others as well as what it pays for production bought from others. This is true even where it buys crude oil and resells it to others rather than using it in its own refineries. Crude oil sold at a point elsewhere than at the producing premises is sold at the posted field price plus transportation.

A typical fully integrated oil company will have the following departments: Exploration and Production Department, Oil Trading Department, Manufacturing Department, Marketing Department and the Administrative Department. The names of these departments, of course, vary somewhat from company to company and some companies departmentalize to an even greater extent. The Skelly Oil Company, for instance, has six operating departments and four administrative departments. The operating departments are known as: Geology and Geophysics, Land and Leases, Oil and Gas Production, Manufacturing, Marketing, and Pipeline Departments. The administrative departments are Accounting, Purchasing, Law and Secretary-Treasurer. Skelly has broken down the exploration and producing activity into three departments, i.e. Geology and Geophysics, Land and Leases, and Oil and Gas Production. The marketing activity has been divided into Marketing and Pipeline Departments. The administrative functions have been separated into four subunits. For the purpose of this paper, we will assume an integrated oil company has the five basic departments mentioned in the first sentence of this paragraph.

In order to provide background for the later discussion of Wisconsin income/franchise tax problems, a brief review of the activities of each department follows.

The Exploration and Production Department, as its name implies, is concerned with the finding and production of crude oil and natural gas. Geologists, geophysi-

cists and oil scouts (or spys) are continually involved in the search for new reserves of oil and gas. While tremendous scientific advances have been made, there is still only one way to determine the existence of oil in a particular area, and that is to drill for it. Exploratory wells, or wildcats as they are called, have about a one-out-of-nine chance of being productive and, we are told, about a one-in-forty chance of being a commercial success. Since oil and gas reserves close to the surface of the earth are now fairly well depleted, oil companies are finding it necessary to drill to depths greater than 20,000 feet and to drill into the floor of the ocean, many miles from dryland. Consequently, the cost per well is very often far in excess of one million dollars. In most cases, wells are drilled for the principal purpose of finding crude oil. When oil is found, natural gas is often found with it or, very often, only natural gas is found. One of the major accounting problems in the industry is to devise an acceptable method of allocating costs between crude oil and natural gas. For tax purposes we assign the same amount of profit per sales dollar to natural gas as to crude oil.

When a company decides to acquire leases in likely productive areas, outside lease brokers are usually engaged on a commission basis. As a rule the brokers obtain leases in their own names or those of nominees and do not reveal the names of their principals, since disclosure that major oil companies are interested in the area sends lease prices skyrocketing. An oil lease is a contract between the landowner and the oil operator, giving the operator the right to explore for and produce minerals existing below the surface of the land. Leases are usually in a standard form and provide, among other things, for:

1. An initial payment of a lease "bonus".
2. The payment of a stipulated "delay" rental for the privilege of deferring drilling operations for an additional year beyond the first year.

3. A primary term, say five years. Despite the primary term, the lease remains in effect so long as oil or gas in commercial quantities is produced from the lease.
4. The amount of the royalty retained by the landowner from production. The standard lease provides that the lessor is entitled to 1/8 of the oil or gas produced, delivered free of cost into the pipeline, or to the proceeds from the sale of such oil or gas.

Much of the crude oil purchased and subsequently resold or refined by an oil company is the purchase of the lessor's 1/8 royalty interest. For book purposes, most companies capitalize and amortize the lease "bonus" mentioned in (1) above and expense currently the "delay" rentals described in (2). Since the "bonus" becomes part of the company's cost of the lease and of the eventual oil and gas produced, recoverable when production occurs by means of depletion, book amortization of the bonus is not deductible. Lease "delay" rentals are made not for extracting the oil and gas, but for failing to do so. "Delay" rentals give the lessee the right to hold properties prior to the discovery of gas or oil or the commencement of drilling. The "delay" rental is deductible when paid or accrued.

In addition to acquiring leases in unproven areas, nearly all companies acquire (and dispose of) leases in proven and semi-proven fields. These leases are usually acquired from other operating companies or from lease brokers or promoters. The conditions under which such leases are acquired vary from straight cash purchase of the working interest to a variety of arrangements for cash and other considerations such as an overriding royalty, a retention of part of the working interest, a carried interest, a net profits interest, an oil payment, a "farmout", or an exchange. Leases are rarely acquired outright, since the original lessor seldom wishes to relinquish control of an area. For that reason, the above methods of buying and selling operating rights have been devised. As explained later, a company selling operating rights and subsequently receiving overriding royalty income, working interest income, carried interest income, net profits

interest income, oil payment income, or etc. is receiving apportionable business income except to the extent an economic interest in oil and gas in place was retained by the seller and income is derived from the subsequent sale of such oil and gas. Major oil companies, almost uniformly, have contended, and the department has finally agreed, that leases are inventory to the oil industry and the purchase, sale or surrender thereof produces apportionable business income or expense. Consequently, we can say that any subsequent income, derived from a retained interest, which is not the result of the disposal of an economic interest in oil or gas in place, is apportionable business income related to the disposition of leaseholds. A detailed explanation of these interests may be obtained from oil and gas accounting textbooks maintained in the Corporation Section library.

The cost of oil properties is usually classified as follows: (1) Leasehold Costs, (2) Intangible Drilling and Development Costs, and (3) Lease and Well Equipment.

Leasehold costs are comprised of geological and geophysical expenses, scouting costs, title examination fees, recording and filing fees, documentary stamps, lease brokers' commissions and expenses, and a portion of field and land office expenses. Such costs are usually accumulated during a year in an account called Leasing and Exploration Costs. In general, the Leasing and Exploration Cost account comprises all costs incurred in the search for and acquisition of leases, except the lease bonus cost and lease rentals. Lease bonuses and rentals are accounted for elsewhere. For book purposes, some companies charge leasing and exploration costs against income currently; however, most companies capitalize these costs. For tax purposes, leasing and exploration costs, as well as lease bonus costs, must be capitalized and deducted by means of depletion.

When leasehold costs are capitalized, they are first carried in the ledger accounts as Unoperated Acreage or Undeveloped Leaseholds. When a lease becomes productive, these costs are reclassified to Operated Acreage or Productive Leaseholds. As mentioned previously, the oil industry maintains, and we have agreed, that leases are inventory to this industry. It follows, therefore, that unoperated acreage is the basic raw material (inventory) of the Exploration and Production Department upon which exploration and drilling activities as continuously performed and without which the ultimate objective, production, could not be achieved. Dry-holes on unoperated acreage are sometimes used to dispose of salt water acquired in the course of drilling other wells. In recognition of the foregoing, the department has taken the position that unoperated acreage is "tangible property" includable in the computation of the property factor of the apportionment formula.

Intangible Drilling and Development Costs represent those expenditures that do not have a salvage value incurred in the drilling and deepening of wells. Such costs include labor in drilling the well or the amounts paid to the drilling contractor for the drilling, labor for preparing the drill site, shooting and logging and formation testing, cementing the wells, material and equipment lost, and a portion of camp expenses, superintendence, and district overhead. These costs are very significant, representing the major portion of each well's total cost. It is the usual practice of major companies to capitalize such costs of productive wells on the books and to amortize them over the estimated useful life of the property. For federal tax purposes a company has the option either to expense or to capitalize these costs. The option to expense intangible drilling and development costs may be made federally by deducting such costs in the first year they are paid or incurred. Although no formal statement is necessary, a failure to deduct such costs in the first year is deemed by the Internal Revenue

Service to be an election to capitalize the costs. If a company elects to capitalize intangible drilling and development costs, the federal regulations grant a second option to either expense or capitalize dry hole costs. The election regarding the dry hole costs is made when the well is completed. Notwithstanding the statement at paragraph 65.1, page 273 of our Training Manual, to the effect that such expenses must be capitalized and depreciated for Wisconsin tax purposes, it has been the practice of this department to follow the federal procedure allowing the above options. This practice no doubt has practicality as its basis, since to try to develop procedures relative to oil operations which are different than those of the Internal Revenue Service could lead to other complications which would make the filing of a Wisconsin tax return by an oil company too complex and costly.

As a general rule, it may be said that most companies for book purposes capitalize intangible development costs as they are incurred and charge the cost of a dry hole to expense at the time drilling and testing are completed. However, frequently a distinction is made in the book accounting treatment between wildcat or exploratory wells and development wells. A wildcat or exploratory well is a well drilled in an unproven area. An average of only about one out of nine such wells is completed as a producer. A development well is a well drilled in a proven area, and the changes of success are substantially greater than for wildcat wells. In recognition of the fact that most wildcats will result in dry holes, some of the larger companies, that for book purposes capitalize drilling and development costs on development wells, charge intangible drilling and development costs applicable to wildcat wells to dry-hole expense as the charges are incurred. Should the well be a producer, a reversing entry is made capitalizing the amounts previously charged to expense. This is true even though the wildcat well is not completed and found to be a producer until

the following year.

For tax purposes it should be noted that if intangible drilling and development costs are deducted as incurred and where the well is drilled over a two year period, only the second year's portion of such expense will be classified as Dry-hole Expense. The first year's portion will have been deducted as Intangible Development Cost. For return purposes some companies, it has been noted, arbitrarily adjust each year's Intangible Development Cost in order that Dry-hole Expense will state the total cost of holes determined to be dry in a year. For Wisconsin tax purposes, the cost of a dry-hole is an apportionable business expense in the same manner as the cost of the surrendered lease previously discussed. The cost of a dry-hole is an ordinary and necessary expense of finding and producing crude oil.

The Lease and Well Equipment account represents the capital investment in items having a potential salvage value. Such items include the cost of casing, tubing, well-head assemblies, pumping units, lease tanks, heaters, treaters, and separators.

It is common practice for the unit of accounting to be the entire lease regardless of the number of wells on the lease. Accordingly, when one of a number of wells on a lease is abandoned, it is the usual practice not to recognize any gain or loss but to credit or charge such amount, net of salvage, to the applicable reserve for depletion or depreciation. At the time of disposal of an entire lease, gain or loss is recognized. As stated previously, leases are inventory to the oil industry and gains or losses on the disposal thereof are apportionable.

When wells are successful and crude oil production commences, the produced oil

is either transferred to the Oil Trading Department or Sold at the well-head to others. A pipe line gathering system, which may or may not be owned by the producing company, will transport the oil to either the operator's or the purchaser's storage tanks.

Most integrated oil companies do not produce as much crude oil as their own refineries require. This is evident from the large number of independent producers contrasted with the relatively small number of independent refiners. Furthermore, the integrated company can avail itself of only a portion of its own production to meet its refinery requirements because of distances between producing wells and refinery locations as well as differences between the kinds of oil produced and the kinds of oil required by the refineries. To bridge the gap between production and refining, a service department (usually called the Crude Oil Department) is utilized. The principal function of this department is to sell all production not required by or not suitable to the company's refineries and to supply the company's refineries with the kinds and quantities of crude oil needed. The basic sources of crude oil by this department are:

1. Production of the company's own oil from wells operated by the company or from wells operated by others.
2. Production of oil owned by other interests from wells operated by the company.
3. From other operators or dealers in oil.

The terms of most oil leases or other agreements require that the well operator purchase the other interests' share of oil produced. As mentioned previously, these interests may be royalty interests, working interests, net profits interests, carried interests, oil payments, etc., as the case may be.

An oil company therefore has in its storage tanks or pipelines at any given time crude oil acquired from the sources listed above. The sale before entering

the refining process of such crude oil produces apportionable or non-apportionable income, depending upon the source of the oil. The sale of crude oil acquired by purchase from others, categories (2) and (3) above, in all cases produces apportionable business income (or loss). The only transaction, involving the sale of crude oil, producing non-apportionable income is the sale of oil in category (1) above; namely, the sale before entering the refining process of a company's own oil acquired directly from a well. For example, this includes both income from the sale of oil owned and produced by operator A as well as from the sale of oil owned by operator A but produced by operator B because of operator A having an owned interest in operator B's production. The criteria is not so much who pumped the oil to the surface, but who owned the oil while it was still in place in the underground oil pool. Although the Wisconsin Statutes do not mention crude oil specifically, income from the sale thereof is deemed to be the same as income from a farm, mine or quarry, which income is non-apportionable following the location of the property from which derived according to Section 71.07 (1) of the Wisconsin Statutes.

As briefly mentioned earlier, production from oil and gas wells varies anywhere from a completely vaporized to a liquid substance. Production from gas wells is generally all vaporized and is called "natural gas", while the vaporized portion of the production from petroleum wells is referred to as "casinghead gas". Raw gas (natural or casinghead) as it comes from the ground may be described as "wet" or "dry", and "wet" gas may be further described as being "rich" or "lean". Generally speaking, gas produced from gas fields is "dry", while gas produced in conjunction with oil is usually "wet" and "rich". "Dry" natural gas is very often sold at the well-head directly to purchasers who distribute such gas by means of pipeline throughout the country. "Wet" gases are either "dried-out" in the producer's own natural gasoline plants or are

sold to another operator having a natural gasoline plant in the vicinity. From the "wet" gas the natural gasoline plant produces natural gas and raw natural gasoline. Because raw natural gasoline is unstable and therefore unsuited for motor fuel, it is further separated into highly marketable liquified petroleum gases such as butane and propane and a stable natural gasoline suitable for blending with gasoline refined from crude oil.

The natural gas owned, produced and sold directly at the well-head without any processing performed on it, produces non-apportionable income in the same manner as crude oil. The sale of natural gas extracted from raw "wet" gas, as well as all other extracted products, does not produce non-apportionable income; such income is apportionable. Some companies buy "wet" gas from others for processing in their natural gasoline plants. Sales of extracted natural gas in this situation, of course, also produces apportionable income. Gases have been discussed in some detail here so that the auditor may be aware that not all sales of natural gas produce non-apportionable income.

The Manufacturing Department of the oil industry presents a few problems insofar as Wisconsin income or franchise tax is concerned because very little of this activity occurs in Wisconsin. None of the companies with whom we have experience has refining facilities in Wisconsin. Therefore, we have a zero cost of manufacturing factor. The principal problem with this factor concerns weighting, which is discussed later.

In the marketing of petroleum products, many more independently owned business units are involved than in any other segment of the industry. Capital requirements at the retail level are not so great, and an individual may compete successfully with company-operated service stations. In the fully integrated company, however, hundreds, if not thousands, of products are offered for sale

and groupings of these products are used for accounting purposes. A representative list of products sold would include:

Gasoline
Lubricating oils - automotive and industrial
Greases - automotive and industrial
Fuel oil
Distillates - diesel and furnace oils
Kerosene
Asphalt
Chemicals
Specialties, such as automotive parts and accessories and promotional items sold by service stations

The marketing department's responsibilities extend further than the sale of products, however. They include many services, the best known of which are those the motorist receives at the retail service station. The role of the marketing department in the transportation of products is also important. From the refinery to the terminal, transportation is usually by pipeline or marine operation. From the terminal to bulk plants, it may be by barge, tank car, or tank truck and from there to the retail consumer or wholesaler by truck.

The operating units of the marketing department may be grouped as follows:

Terminal. A facility equipped
1. To receive large quantities of products by pipeline, tanker barge or rail
2. To store large quantities of these products
3. To ship large quantities to bulk plants, retailers or consumers.

Bulk Plant. A smaller facility than the terminal equipped to store product and deliver by truck to smaller wholesalers, retailers and consumers.

Service Station. A property for the retailing of products to motorists. Most oil companies do not operate their own stations, but instead have independent managers operating on a commission basis.

Prior to 1949 the separate accounting method was used by the oil industry to compute income subject to the Wisconsin tax. This method was upheld by the

Wisconsin Supreme Court in the Standard Oil Company of Indiana case. In 1949 the Legislature amended Section 71.07 (2) requiring apportionment for unitary businesses. The fact that oil companies paid little tax had much to do with the passage of this amendment. Most oil companies are now voluntarily reporting on the apportionment basis.

Total Company Net Income

The computation of total company net income before apportionment for oil companies is little different than that for any other large company. In the same manner as with many companies, federal taxable income is used as a starting point and such income, by means of specific adjustments, is converted to Wisconsin net income. A major item in the computation of federal taxable income involves the 27 1/2 percent percentage depletion allowance. The Wisconsin law, of course, has no provision for percentage depletion of crude oil or gas. The percentage depletion deduction claimed federally, therefore, should be reversed and cost depletion allowed. By reversing the federal Schedule M adjustment for the excess of percentage depletion over book cost depletion, we, of course, are left with book cost depletion. Because of differing methods (previously discussed) of treating exploration and production costs, the book and tax depletable costs may differ somewhat. Consequently, Wisconsin cost depletion may be more or less than book cost depletion and Wisconsin gains and losses on disposition of leaseholds may differ somewhat from the federal. Intangible development costs, as stated earlier, are deductible when incurred in the same manner allowed federally. In general, it is well to follow federal taxable income as closely as possible.

Non-Apportionable Income

The computation of non-apportionable income for oil companies has all of the normal problems encountered in the returns of most unitary multi-state

businesses. However, the amount of income following the situs of property is much more significant than normal and the determination of such income, if not more complex, is at least unique.

The operations of an integrated oil company are, in general, unitary. Each of its activities - beginning with the search for oil and gas, the production of discovered oil and gas, the transportation and storage of produced as well as purchased oil and gas, the refining of such oil and gas, to the ultimate marketing of end products derived from these basic raw materials - benefits and is benefited by its other activities. As discussed previously, however, income from the sale of produced oil and gas generates non-apportionable income to the extent such oil and gas is sold to outsiders before entering the refining process. Sales of this nature may occur at the well-head where the sale is made by the Exploration and Production Department or the sales may be made by the Oil Trading Department after produced oil has been co-mingled with oil purchased from others. Natural gas is usually sold by the Exploration and Production Department.

As mentioned briefly earlier, the theory behind this treatment is the same as that applied to income derived from farms, mines or quarries. To the extent that products obtained from farms, mines or quarries owned and operated by a manufacturing concern are consumed or become components of end products of the manufacturing company, that portion of the net income of the farms, mines or quarries generated by these products is unitary business income. To the extent that products of the farms, mines or quarries do not enter the unitary operation (in other words, are sold in the same state as they are in when produced) the net income generated therefrom follows the situs of the property from which derived, pursuant to Section 71.07 (1) of the Statutes.

Since the Exploration and Production Department and the Oil Trading Department produce both apportionable and non-apportionable income, the accounting problem we are faced with is to isolate the net income generated by sales producing non-apportionable income. This is done by means of formulas which derive a percentage of barrels of produced crude oil sold to outsiders by each department to the barrels of all crude oil (both produced and purchased) available to (or passing through) each department. Exhibits E-4.3 and E-4.4 of the attached E section of the audit report show the computation of these ratios.

In the computation of non-apportionable income from the sale of crude oil, some companies incorrectly include gross income from the sale of "carved-out oil payments" or from the "sale of oil in place." These two names describe the same transaction. In such an arrangement, the seller of the carved-out oil payment disposes of a horizontal slice of oil in place, retaining reversionary rights to the remaining oil. More simply put, a well operator sells oil in the ground to a third party, very often a bank, receiving cash for a given quantity of future production of crude oil. The seller continues to operate the property, but is required to repay the cash advance from a specified percentage of future production of certain wells. Since the dollar value of the crude oil eventually turned over to the purchaser is greater than the dollar value of crude oil the cash advance would have purchased on the day the advance was made, the buyer in effect earns interest on the transaction. This is the reason why banks are willing to invest in "oil in place".

A carved-out oil payment is sold for several reasons, the principal ones being: (1) to obtain additional working capital without borrowing money (the principal purpose of small undercapitalized companies), (2) to average income and (3) to generate just enough income to qualify for the maximum percentage depletion

deduction. Most large companies are only concerned with the percentage depletion deduction. The sale of oil in place generates gross income against which there are no current producing expenses, because sales of this nature are made at year end when a company can determine exactly the net income necessary to produce the maximum percentage depletion within the 50 percent net income limitations imposed by the Internal Revenue Code.

For book purposes, the proceeds from the sale of carved-out oil payments may be treated as ordinary income when received, since none of the amount is refundable to the purchaser under the standard agreement which provides that the payments will be made only out of oil produced. In most cases, however, the amount received for the oil payment is treated as a deferred credit and is taken into income only as the oil is produced (this may extend over a period of years).

For federal tax purposes, amounts received from the sale of carved-out oil payments must be reported in the year of receipt as ordinary income, pursuant to the decision of the United States Supreme Court in the case of P. G. Lake, Inc. et. al. vs. Commissioner. In this case the United States Supreme Court held that carved-out oil payments are only assignments of rights to future income, and hence, the proceeds from the sale thereof are ordinary depletable income not subject to capital gain treatment.

For Wisconsin tax purposes, income from the sale of carved-out oil payments is ordinary income from the production of crude oil in the same manner as federally. Such income is also non-apportionable to the extent it is offset by all related expenses of the Exploration and Production Department. Related expenses include, among others, a share of dry hole costs, costs of surrendered leases, depletion, and intangible drilling and development costs. A

problem arises, however, insofar as the year in which income from the sale of "carve-outs" should be included in total income. If we take-up such income in the year received, as the Internal Revenue Service does, we will have no barrel production data relative to such income in our formula shown on Exhibit E-4.3. Consequently, the barrels of produced crude sold will be understated, and non-apportionable income, as a result, will be too low. In addition, the costs of producing the oil will be in a year different than the year in which the proceeds are included in total income. A poor matching of costs and revenues results. Therefore, it has been found to be practical to include income from the sale of carved-out oil payments in income on the book deferral method. Federal Schedule M adjustments for this income, consequently, should be reversed on Exhibits C and E-4.1, if the taxpayer is agreeable thereto. We probably cannot insist on changing the federal method, inasmuch as the advanced proceeds do constitute income in the year of receipt (because they are not refundable). If the taxpayer wants the federal treatment, we must estimate production barrel data and lifting costs applicable to such income.

Many oil companies have a marine operating unit which may be a separate department or which may be part of the Manufacturing or Marketing Departments. This marine unit operates tankships (tankers) and specially constructed barges along coastal and inland waters of the United States. Because of their economy, such vessels can compete with pipe lines and tank cars in the transportation of bulk quantities of petroleum and refined products. The movement of petroleum is usually a one-way operation, with no return cargo. Tankships are of a special design; therefore, their use is largely confined to the movement of petroleum, although occasionally these vessels may transport some other liquid cargo, such as molasses.

Although a marine unit is involved primarily in transporting the company's own products, income is earned from transporting the products of others. Such income is business income and entirely apportionable. On occasion, however, a company having unused vessels will rent these vessels to others under a "bareboat charter" or "time charter" arrangement. In a "bareboat charter" the charterer receives a ship in goodworking order but without a crew, fuel and other operating supplies, and must staff the vessel with his crew and assume full responsibility for the operation and maintenance of the vessel. In a "time charter", on the other hand, the owner offers the use of a fully staffed vessel for trading within prescribed areas at a monthly rate per deadweight ton and agrees to make voyages as directed by the charterer and to assume most expenses of operating the vessel. Net income derived from both "bareboat" and "time" charters is non-apportionable rental income following the situs of the vessels.

Rental income is also earned from the lease of service stations to commission managers and other independent contractors. Income or loss derived from rentals to others of service stations owned or leased by the oil company, in most cases, is treated as apportionable by mutual agreement because it has not been possible to accurately determine such net income or loss of the net depreciated tangible property related to rentals of this nature.

Contributions made by the Exploration and Production and Oil Trading Departments are not split between apportionable and non-apportionable income. All contributions made by these and other departments are deductible. The net income of the Exploration and Production and Oil Trading Departments computed on Exhibits E-4.1 and E-4.4 should be increased by the amount of contributions included in expense before the determination of departmental non-apportionable income.

Apportionment Factors

The statutory apportionment formula set forth in Section 71.07 (2) is used in the computation of Wisconsin net income. That is, the average of the tangible property, cost of manufacturing and sales factors is applied to total apportionable income in the determination of business income earned in Wisconsin.

Tangible Property Factor

The tangible property factor is computed as shown on Exhibit E-1. The special consideration involved in the computation of this factor is the determination of property used in the production of non-apportionable Exploration and Production Department, Oil Trading Department and Marine Operation net income. The net tax basis cost of property in each department or operation must be computed and the amount thereof pertaining to non-apportionable income or loss eliminated. The amount to be eliminated is determined by applying the ratio of each department's total income that is non-apportionable to total tax basis property of that department. Since Exhibits D and D-1 are rarely prepared for oil companies because of the size of the task, it must be remembered that Intangible Development Costs capitalized for book purposes, but expensed for tax purposes, must be eliminated from book costs. These costs are significant and can make a material difference in the tangible property percentage because all are outside Wisconsin. Many companies include these costs in the factor. Of course, other material differences between book and tax net costs should also be adjusted for. The cost of unoperated acreage, as previously explained, is "inventory" to the oil industry and, hence, includable in tangible property.

Cost of Manufacturing Factor

The cost of manufacturing weight is computed on Exhibit E-2. Few oil companies have manufacturing operations in Wisconsin. The Wisconsin cost of

manufacturing factor, therefore, is zero. Inasmuch as most oil companies sell products purchased from others on which further manufacturing is not performed prior to resale, this factor must be weighted in order to recognize the fact that not all apportionable income is influenced by the company's own manufacturing activities. The primary items for which weighting is necessary are:

1. Resale of refined products purchased from others,
2. Resale of motor vehicle parts and accessories, such as, batteries, tires, tubes,
3. Resale of crude oil purchased from others.

Some companies object to weighting for the sales of crude oil purchased from others on the grounds that such sales produce little income because the oil in many instances is bought and sold at the same "posted field price". A counter argument to this position is that the sales of purchased crude oil are included in the denominator of the sales factor. If such sales produce no revenue, it can be argued that they should be eliminated from the sales factor computation.

Sales Factor

The sales factor is computed on Exhibit E-3. The special considerations in the computation of this factor are primarily the same as in the computation of the tangible property factor. That is, the sales of crude oil, natural gas and other minerals, as well as income from the chartering of vessels included in sales, must be determined and eliminated from total sales. In addition it should be noted that sales of oil companies are usually recorded gross of product taxes, such as federal and state gasoline taxes, even though state gasoline taxes, as a rule, are imposed upon the consumer. Federal gasoline taxes are imposed on the producer or ultimate retailer. For sales factor purposes, product taxes imposed on the consumer but collected and remitted by the oil company, in theory, should be excluded from sales. Information to adjust the

numerator and denominator of the sales fraction for product taxes may not be readily available. Consequently, the adjustment may not be feasible. It is important, however, to determine that product taxes have been treated consistently in both the numerator and denominator of the sales factor.

Sales Tax

In the discussion of the Marketing Department it was brought out that oil companies sell lubricating oils and greases as well as automotive parts, supplies and accessories. They also sell special promotional items to or through service stations.

Section 77.52 (1)(a) 4 of the Wisconsin Selective Sales and Use Tax Law, which became effective on August 15, 1963, imposes a 3% tax on the sale, lease or rental of motor vehicles and the accessories, attachments, parts, supplies and materials therefor, except motor fuel. To the extent that oils and greases are specifically designed, manufactured, marked and recommended for use in automobiles or other motor vehicles, oils and greases are motor vehicle supplies. Beginning with August 1, 1967, sales of these lubricants are subject to the sales tax whether or not sold in "bulk lots" and regardless of the use to which they are put. Other motor vehicle parts, supplies, attachments and accessories have been subject to the tax since August 15, 1963. Special promotional items sold could be of any kind and may be subject to the tax. The repair, service and maintenance of motor vehicles are subject to the tax pursuant to Section 77.52 (2)(a) 8.

Prior to August 1, 1967 confusion existed as to which oil and greases were subject to the tax. In the early days of this sales tax law, rulihgs were published to the effect that oils and greases sold in "bulk lots" were unidentifiable as to purpose, and, consequently, were multi-use goods not subject

to the tax unless used in motor vehicles. As a result, many retailers did not charge the tax on any sales of lubricants unless they were actually installed in motor vehicles.

After audit of several oil companies and discovery of the existing confusion, as well as the facts relative to the manufacture of lubricants, a conference was held at which representatives of this department met with members of the Wisconsin Petroleum Council and representatives of most major oil companies. This meeting confirmed the fact that oils and greases are engineered for specific purposes and that all companies brand, mark or classify oils and greases according to intended and recommended useage (automotive or industrial), notwithstanding the fact that automotive lubricants may be used for industrial purposes and vice versa. Each company agreed to submit to the Wisconsin Department of Revenue a list of all products designed, manufactured and branded, marked or classified as "automotive lubricants." Each company also agreed to charge the sales tax on all sales of products on its list and on the sale of any new products of the same nature subsequently added to its product line.

The taxation of all sales of motor vehicle lubricants regardless of quantity or end use is effective as of August 1, 1967 by ruling of the Secretary of Revenue. Application of this position is not retroactive to periods prior to this date. The auditing of retailers for these sales should, no doubt, be dispensed with for all periods prior to August 1, 1967. Some of the sales tax lost in these periods may conceivably be recovered in the form of use tax from large industrial consumers who used the products on motor vehicles. Audits of periods after August 1, 1967 not only should verify that sales tax was charged on all lubricants on the lists, but also that all lubricants subject to the tax are on the lists.

Products subject to the sales tax are sold by three marketing facilities described earlier in the discussion of the Marketing Department. These facilities are terminals, bulk plants and service stations. Terminals sell motor vehicle lubricants to wholesale jobbers and distributors, to retail dealers and to large industrial and governmental consumers. Bulk Plants sell motor vehicle lubricants on a smaller scale to the same customers as well as to farmers. Service stations, of course, sell service and motor vehicle supplies, parts, attachments and accessories primarily to the individual consumer.

Most major oil companies do not operate service stations. Instead, they lease stations to independent operators who either buy and resell the oil company's products or who act as agents, selling the oil companies products on a commission basis, but operating the remainder of the station independently of the oil company. Even though most stations are leased to others, oil companies operate stations with their own employees at times when independent operators cannot be found, in order that stations do not stand idle.

Sellers' Permits, of course, are required for each station operated by employees of the oil company. They also are required for leased service stations operated by independent operators acting as agents in the selling of the oil company's primary products. Two sellers' permits are required in this last situation - one for the oil company and one for the independent operator (for his sales of other owned goods and services).

Use Tax

Section 77.52 (1)(a) 9 exempts tanks, pumps, compressors and equipment for the retail marketing of petroleum products from the sales tax. Purchases of such equipment for service stations therefore are not subject to the use tax.

However, the department has ruled if these same items are attached to motor vehicles after November 1, 1963, they are subject to the sales tax. Therefore, tanks, pumps, compressors and equipment used for the retail marketing of petroleum products and purchased tax-free from out-of-state vendors are subject to the use tax if attached to motor vehicles in Wisconsin after November 1, 1963.

Other items of taxable tangible personal property which probably would be purchased by terminals, bulk plants or service stations are:

Motor vehicles	-	terminals,	bulk plants,	service stations
Fork lift trucks	-	"	"	—
Small conveyors	-	"	"	—
Office equipment	-	"	"	"
Fans, heaters, blowers	-	"	"	"
Cash registers	-	"	"	"
Air conditioners	-	"	"	"
Vending machines	-	—	—	"
Water coolers	-	"	"	"
Display cases and counters	-	—	—	"

Withholding Tax

Oil companies have no unusual problems insofar as withholding tax is concerned.

EXHIBIT 15

WISCONSIN TAX APPEALS COMMISSION

EXXON CORPORATION, (successor by merger to Humble Oil & Refining Company),	:	
Petitioner,	:	STIPULATION AS TO CERTAIN FACTS AND DOCUMENTS
vs.	:	
WISCONSIN DEPARTMENT OF REVENUE,	:	Docket No. I-3806
Respondent.	:	

DOCUMENTS

Petitioner and Respondent, by their respective attorneys, stipulate and agree that the following described documents, bearing the exhibit numbers, respectively, set opposite the summary identifications thereof, are either the originals or true and correct copies of the originals thereof, and shall be admitted into evidence in this action and made part of the record for purposes of all hearings, trials and appeals in this cause to provide undisputed evidence of the authenticity, existence and contents of such documents, with the reservation that each party reserves the right to argue the relevance of any data contained in the documents.

Exhibit No.	Summary Identification
1	Notice of Assessment and Audit Report 1965-1968
2	Notice of Assessment and Audit Report 1960-1964
3	Application for Abatement of 1965-1968 assessment
4-A	Notice of Denial of Application for Abatement 1965-1968

#15

4-B		Notice of Partial Denial of Application Abatement 1960-1964
5-A		Petition for Review
5-B		Petition for Amendment and Order
6		Answer of Respondent
7		Discovery Transcript of Examination of Thomas J. Sheridan
8		Discovery Transcript of Examination of Kurt Kaspar, Jr.
9		Discovery Transcript of Examination of Carl J. Hoel
10		Discovery Transcript of Examination of John K. Leidiger
11		Discovery Exhibits:
	11-1	Subpoena Duces Tecum
	11-2	Work Papers of Kurt Kaspar on 1960-64 audit
	11-3	Work Papers of Kurt Kaspar on 1960-64 audit
	11-3A	Staff Conference Notes, November 30, 1966.
	11-4	Original Returns 1964 - and Misc. correspondence and memos
	11-5	Work Papers of T. J. Sheridan, dated May 1, 1971 (B, C & F).
	11-6	Work Papers of T. J. Sheridan, dated May 1971 (D & E).
	11-7A	1965 Wisconsin Corporation Franchise Tax Return
	11-7B	1966 Wisconsin Corporation Franchise Tax Return
	11-7C	1967 Wisconsin Corporation Franchise Tax Return
	11-7D	1968 Wisconsin Corporation Franchise Tax Return
	11-9	Staff Conference Notes
	11-10A	Excerpt from Department of Taxation Training Manual - Chapter 16, Situs of Income.

11-10B	Excerpt from Department of Taxation Training Manual - Section 65, Depletion.
11-11	Paper entitled "Auditing Oil Companies" by Kurt Kaspar, Jr. and Ralph Paul
11-12A	Report entitled "Determination of Wisconsin Taxable Income of Oil Companies" by C. M. Lins
11-12B	Report entitled "Factual Materials Which an Auditor Should Have in His Work Papers to Prove that a Taxpayer is Engaged in a Unitary Business" by Lee Longhorn.
11-13	Income Tax Regulations Act of 1931, Published September 1932. Section VI - Apportionment, Separate Accounting and Situs of Income.
11-15	Miscellaneous papers
11-16	Material submitted by Humble 1960-64 Audit
11-17	Conference Notes, May 9, 1967
11-18	1959, 1960, 1961 and 1962 Wisconsin Corporation Franchise Tax Returns
11-19	1963 Wisconsin Corporation Franchise Tax Return
12	Paper entitled "Wisconsin's Experience in the Taxation of Oil Companies" by J. K. Leidiger
13	Certified copies of Humble Oil & Refining Co. annual reports on file with Wisconsin Department of State
14	Certified copy of Plan and Agreement of Merger effective June 30, 1960

FACTS

Petitioner and Respondent, by their respective attorneys, hereby further stipulate and agree, for the purposes of this action only, to the truth of the following facts and to the admissibility

of this Stipulation into evidence in this action for use in all hearings, trials and appeals in this cause for the purpose of providing undisputed evidence of such facts.

JURISDICTIONAL FACTS

1. Petitioner timely filed its Wisconsin corporation income and franchise tax returns for the calendar tax years of 1965 to 1968, both inclusive. The returns were prepared and the computations made on the separate accounting method. Losses were shown in the amounts of $821,320; $1,159,830; $1,026,224; and $919,575, respectively, for the years 1965, 1966, 1967 and 1968, aggregating $3,926,949 for the four year period. No tax was shown as being due for any such year.

2. Under date of June 25, 1971, C. J. Hoel, Section Chief of the Respondent, forwarded to Petitioner a Notice of Assessment of Additional Income and Franchise Tax (Exhibit 1), to which there was appended the Franchise Tax Audit Report (the "Audit Report") of Mr. Thomas J. Sheridan dated May 1, 1971, in which he found that Petitioner's income was subject to apportionment, which subjected it to tax on or measured by additional income of $4,532,155 for the period 1965 through 1968. Additional taxes in the amount of $316,470.85 were thereby assessed against Petitioner. These documents were received by Petitioner on June 28, 1971.

3. Under date of July 21, 1971, Petitioner timely filed an Application for Abatement (Exhibit 3). On October 26, 1971, an informal conference was held on the Application in the offices of the Respondent at Madison, Wisconsin.

4. Under date of November 30, 1971, C. J. Hoel, forwarded to Petitioner a Notice of Denial of Application for Abatement

(Exhibit 4), to which there was appended a Notice of Additional Taxes Due, dated November 30, 1971, in the principal amount of $316,470.85, plus interest.

5. On December 30, 1971, Petitioner timely filed a Petition for Review by the Commission (Exhibit 5), and subsequently Respondent timely served and filed its Answer (Exhibit 6).

BACKGROUND FACTS

6. Petitioner subsequently made an Application for Discovery Authorization, which the Commission granted on May 26, 1973; and the discovery examinations of four employees of the Respondent were conducted on January 15 and 16, 1974 and the transcripts of such examinations are Exhibits 7 through 10 herein. Pursuant to a Subpoena Duces Tecum served upon Respondent by stipulation with its counsel, Respondent produced the documents sub-numbered under Exhibit 11 herein and others, indicating that such documents constitute all documents known to Respondent covered by the enumerated categories in the Subpoena and pertinent to the audit and assessment of the Petitioner for the 1965-1968 period of the audit in issue and for the 1960-1964 period of the prior audit, with the exception of documents referred to as the "Continental Oil Co. work papers" which were used as a model for the audit of the Petitioner but which Respondent refused to produce and which refusal was upheld by the Commission.

7. Respondent had also audited the Petitioner for the period 1960 through 1964, which audit was conducted for Respondent by Kurt Kaspar, Jr. The Notice of Assessment and Audit Report for that period is Exhibit 2 herein.

8. Petitioner Exxon Corporation (hereinafter "Exxon") was formerly named Standard Oil Company of New Jersey (hereinafter "SONJ") which prior to the name change in early 1973 was the owner of a wholly owned subsidiary corporation named Humble Oil & Refining Company (hereinafter referred to as "Humble"). At about the time of the name change Humble was merged into Exxon, making Exxon the legal successor to the original Petitioner in this action.

9. In 1956 SONJ organized as a wholly owned subsidiary a Delaware corporation named Pate Oil Company, which then acquired all of the assets and liabilities of Saxon Corporation, a Wisconsin corporation whose name had just been changed from Pate Oil Company. The new Pate Oil Company continued the operations of the former company under the name "Pate," which operations were all located in Wisconsin and consisted of the marketing of petroleum products and accessory products. Corporate income tax reporting to the State of Wisconsin was done on the basis of the results of the new corporation's Wisconsin marketing operations, which continued the pattern of the former Pate corporation in reporting all of its income to Wisconsin.

10. On June 30, 1960 SONJ caused (new) Pate to be merged into Humble, and thereafter the Wisconsin marketing operations were continued by Humble with the brand name being changed to "Enco." In early 1973 Humble was merged into SONJ and the latter's name changed to Exxon. Petitioner will be referred to in this case as either "Exxon" or "Humble," and such references are intended, unless otherwise specified, to refer to the legal entity which conducted the Wisconsin operations, named Humble Oil & Refining Company, to which Exxon is now the legal successor.

IN WITNESS WHEREOF, this Stipulation has been executed for the purposes described this 2nd day of October, 1974.

Thomas G. Ragatz
Attorney for Petitioner

Irving F. Shapiro
Attorney for Respondent

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SEE FOLDOUT NO. 1 - 4

EXHIBIT 21

EXHIBIT 21

HUMBLE OIL & REFINING COMPANY
OIL AND GAS OPERATIONS
AND REFINERY LOCATIONS
1960-1968

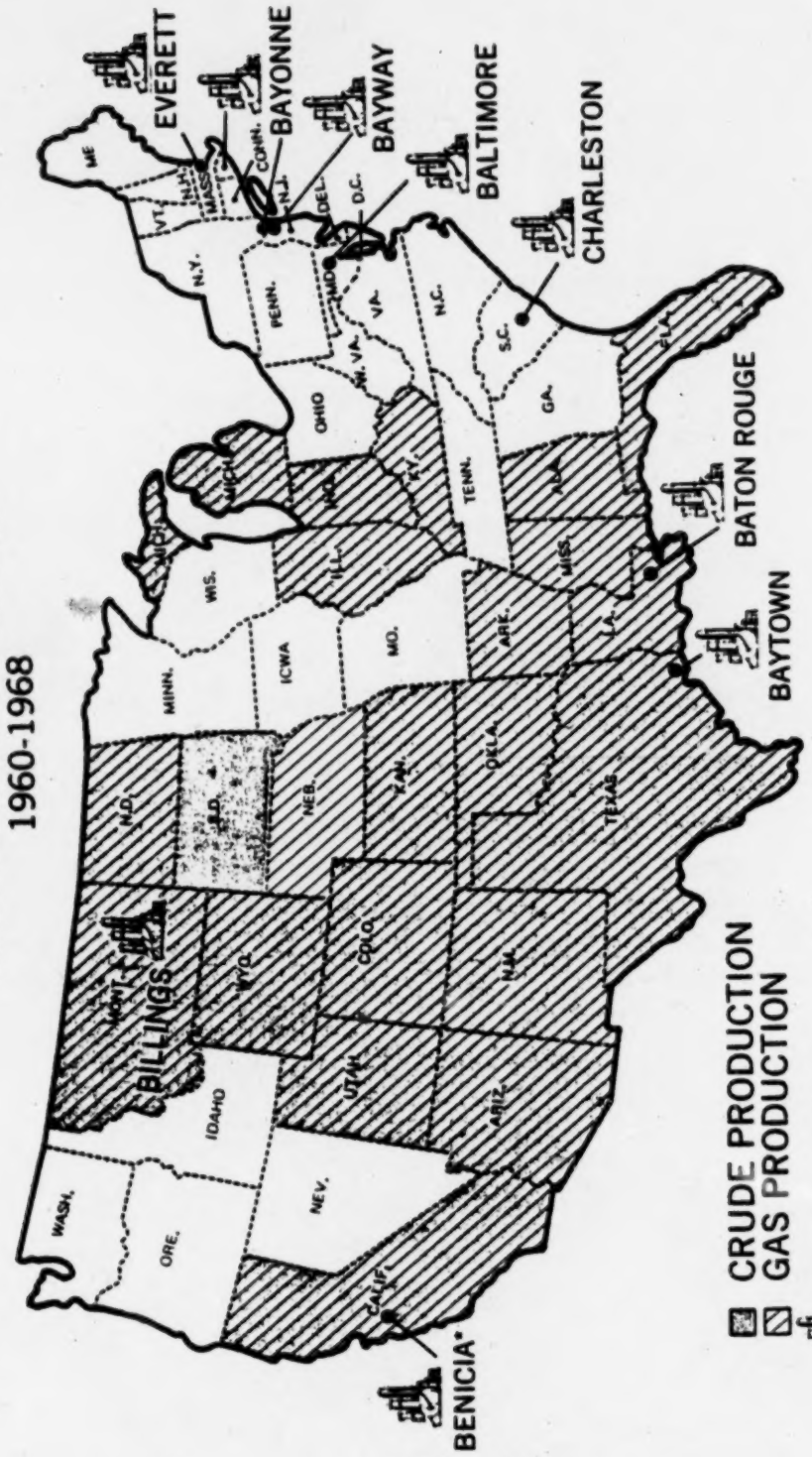

EXHIBIT 22

EXHIBIT 22

COMPANIES ENGAGED IN ONE OR MORE COMPETITIVE OPERATIONS OF THE PETROLEUM INDUSTRY

I. Companies with Exploration and Production, Refining and Marketing Operations:

Murphy Oil Corporation
Skelly Oil Company
Standard Oil Company (Indiana)
Texaco, Incorporated
Union Oil Company of California

II. Companies with Primarily Exploration and Production Operations:

Aztec Oil & Gas Company
General American Oil Company of Texas
General Crude Oil Company
Louisiana Land & Exploration Company
Superior Oil Company

III. Companies with Primarily Refining Operations:

Edgington Oil Company
Rock Island Refining Corporation
Sunland Refining Company
Texas City Refining
U.S. Oil & Refining Company

IV. Companies with Primarily Refining and Marketing Operations:

Beacon Oil Company
Caribou Four Corners Oil Company
Little American Refining Company
Powerine Oil Company
United Refining Company

V. Companies with Primarily Marketing Operations:

East Coast Oil Corporation
Hudson Oil Company, Inc.
Martin Oil Service Company, Inc.
Sigmor Corporation
Star Service & Petroleum Company

Source: Dun & Bradstreet Million Dollar Directory, 1974 classified on the basis of each company's Standard Industrial Classification number(s) prescribed by the U.S. Office of Management and Budget.

3517 #27

3517

A. 758
EXHIBIT 27

SUMMARY OF OPERATING EXPENSES ALLOCATED TO WISCONSIN FOR SEPARATE ACCOUNTING PURPOSES

Expense	1965	1966	1967	1968
Area Expenses:				
Marketing	$181,910			
Accounting	271,391	$ 552,067	$ 407,232	$ 531,778
Other	125,988			
Advertising	534,102	426,933	383,248	337,767
Administrative	249,258	120,137	116,666	209,591
Total	$1,362,676	$1,099,137	$ 907,146	$1,079,136
Reported Loss per Wis. returns	$ 821,320	$1,159,830	$1,026,224	$ 919,575
Wis. Taxable Income if Allocated Expenses Disregarded	0*	0**	0**	0***

*Disregarding 60% +
**Disregarding 100%
***Disregarding about 85%

A. 759
EXHIBIT 28

HUMBLE OIL & REFINING COMPANY

1965 - 1968 WISCONSIN CORPORATION FRANCHISE TAX AUDIT

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III. Schedule C -- 1965
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HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Summary of Alternative Methods of Attributing Income to Wisconsin

Schedule A -- 1965-1968
Page 1 Of 1

Year	State's Hybrid Apportionment		Humble's Wisconsin Separate Accounting		Marketing Function Apportioned Only		Marketing & Refining Apportioned Only		Exploration And Production Separate Business or Allocation to Situs	
	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax
1965	$ 759,371	$ 52,961	($ 821,320)	$ -0-	$ 541,794	$ 37,731	$ 282,383	$ 19,572	$ 310,841	$ 21,564
1966	1,043,395	72,843	(1,159,830)	-0-	316,081	21,931	430,886	29,967	443,520	30,851
1967	1,264,946	88,351	(1,026,224)	-0-	394,993	27,455	490,252	34,123	503,182	35,028
1968	1,464,443	102,316	(919,575)	-0-	833,739	58,167	655,869	45,716	700,086	48,811
Totals	$4,532,155	$316,471	($3,926,949)	$ -0-	$2,086,607	$145,284	$1,859,390	$129,378	$1,957,629	$136,254
	(From Audit Report)		(From Wisconsin Returns)		(From Schedule D)		(From Schedule E)		(From Schedule C)	

Differences With State Audit And:

a) Separate Accounting	$8,459,104	$316,471		
b) Marketing Apportioned Only			$2,445,548	$171,187
c) Marketing And Refining Apportioned Only				$2,672,765 $187,093
d) Exploration And Production As Separate Business Or Allocation To Situs				$2,574,526 $180,217

NOTE: This schedule summarizes the resulting Wisconsin net taxable income and franchise tax liability under four alternative conclusions as to the method for arriving at the net income attributable to Humble's activities in Wisconsin during the years 1965 thru 1968.
1) Separate accounting for Wisconsin marketing activities, as reported in Humble's Wisconsin tax returns.
2) Marketing functional department's net income allocated and apportioned to Wisconsin under the statutory formula, and all other income treated as from separate out-of-state businesses.
3) Marketing and Refining functional departments' combined net income allocated and apportioned to Wisconsin under the statutory formula; and all other income treated as from separate out-of-state businesses.
4) Exploration and Production function's net income treated as (a) a separate out-of-state business, or (b) as income from "mining" allocated to situs, with all other non-allocable net income of Humble apportioned under the statutory three-factor formula.

A. 760

HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
1965 Federal Taxable Income

Schedule B - 1965
Page 1 Of 1

Line No.	Functional Operating Departments: Exploration & Production	Marketing	Refining	Marine	Enjay	Administrative	Total
1. Gross Receipts	$882,627,759	$2,593,111,862	$2,452,668,330	$106,636,099	$310,002,695	($2,278,059,887)	$4,070,986,858
2. Less: Cost of Goods Sold	72,764,620	1,524,207,591	2,273,000,657	75,274,600	153,816,840	(2,265,064,900)	1,833,999,408
3. Gross Profit	$809,863,139	$1,068,904,271	$ 179,667,673	$ 31,361,499	$156,185,855	($ 8,994,987)	$2,236,987,450
4. Dividends	146,388	382				15,833,433	15,980,203
5. Interest - U.S. Obligations	1,233	150				3,683,814	3,685,197
6. Other Interest	177,823	986,109	106	1,501	531,113	1,907,006	3,603,658
7. Gross Rents	1,722	47,691,676	1,248,586	137,671	110	2,114,621	51,194,386
8. Gross Royalties	188,775	1,210				1,907	191,892
9. Net Gains/(Losses)	5,571,653	(56,432)	151,267	(139,300)	(76,495)	634,453	6,085,146
10. Other Income	6,211,735	14,367,720	12,741,444	571,553	4,056,474	3,597,584	41,546,510
11. Total Income	$822,162,468	$1,131,895,086	$ 193,809,076	$ 31,932,924	$160,697,057	$ 18,777,831	$2,359,274,442
12. Compensation of Officers						$ 1,668,281	$ 1,668,281
13. Salaries and Wages	$ 37,927,046	$ 99,168,164	$ 63,399,488	$ 1,402,053	$ 13,499,643	15,557,513	230,953,907
14. Repairs	23,184,790	22,014,264	12,665,260	6,229,643	4,020,025	1,154,238	69,268,220
15. Bad Debts	205,309	5,987,843		69,836	21,907	734,279	7,019,174
16. Rents	17,387,891	37,018,894	3,574,250	142,646	1,070,921	1,663,227	60,857,829
17. Taxes	61,910,441	23,187,372	13,961,017	115,357	3,186,993	1,153,888	103,515,068
18. Interest	178,699	192,107	11,501		70	5,301,048	5,683,425
19. Contributions	2,513,531	795,427	37,611	1,090	2,511	1,952,654	5,302,824
20. Casualty Or Theft Losses	1,875,038	472,615	22,837		1,206,997		3,577,487
21. Amortization		328,531		1,868,472			2,197,003
22. Depreciation	95,989,108	43,982,336	52,031,551	11,718,061	15,119,269	4,807,535	223,647,860
23. Depletion	210,200,000						210,200,000
24. Advertising		22,481,809	7,346		1,392,553		23,881,708
25. (a) Pension, Profit-Sharing, Etc. Plans	8,419,566	10,714,732	12,201,438	1,921,662	931,101	2,339,792	36,528,291
(b) Other Employee Benefit Plans	5,078,654	7,369,169	7,606,377	805,431	319,368	3,466,159	24,645,158
26. Other Deductions	272,331,054	775,456,828	16,134,166	1,798,854	96,437,950	(24,048,877)	1,138,109,975
27. Total Deductions	$737,201,127	$1,049,170,091	$ 181,652,842	$ 26,073,105	$137,209,308	$ 15,749,737	$2,147,056,210
28. Federal Taxable Income - Before NOLD & Special Deductions	84,961,341	$ 82,724,995	$ 12,156,234	$ 5,859,819	$ 23,487,749	$ 3,028,094	$ 212,218,232
29. Less: (a) NOLD						13,458,418	13,583,173
(b) Special Deductions	124,430	325					
30. Federal Taxable Income	*$ 84,836,911	$ 82,724,670	$ 12,156,234	$ 5,859,819	$ 23,487,749	($ 10,430,324)	$ 198,635,059

*Special Note: This Exploration & Production Functional Net Income Figure Was Adopted In The Wisconsin Audit (Exhibit E-4.1, Page 17) To Compute Adjusted Departmental Net Income.

A. 761

HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
1966 Federal Taxable Income

Schedule B - 1966
Page 1 Of 1

Line No.		Functional Operating Departments: Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Enjay	Administrative	Total
1.	Gross Receipts	$974,831,438	$2,738,881,263	$2,492,823,766	$108,687,446	$	$	$	$144,517,244	($2,363,874,226)	$4,095,866,931
2.	Less: Cost of Goods Sold	71,190,814	1,632,219,659	2,260,452,811	70,712,714				70,260,696	(2,359,559,514)	1,745,277,180
3.	Gross Profit	$903,640,624	$1,106,661,604	$ 232,370,955	$ 37,974,732	$	$	$	$ 74,256,548	($ 4,314,712)	$2,350,589,751
4.	Dividends	19	761							19,283,040	19,283,820
5.	Interest - U.S. Obligations	1,250								3,865,666	3,866,916
6.	Other Interest	151,798	1,146,990	51,820	1,837				24,975	2,080,540	3,457,960
7.	Gross Rents		48,709,298	1,567,772						1,248,937	51,266,007
8.	Gross Royalties	233,715	1,102							622	235,439
9.	Net Gains/(Losses)	(4,405,509)	(157,229)	2,987	27,086				222	658,398	(3,874,045)
10.	Other Income	7,689,883	17,928,119	29,380,648	88,777			532,457	1,015,058	2,101,121	58,736,063
11.	Total Income	$907,311,780	$1,174,290,645	$ 263,114,182	$ 38,092,432	$	$	$532,457	$ 75,296,803	$ 24,923,612	$2,483,561,911
12.	Compensation of Officers									$ 1,488,339	$ 1,488,339
13.	Salaries and Wages	$ 38,837,366	$ 100,730,023	$ 61,583,721	$ 3,563,262	$	$	$	$ 6,449,099	22,055,042	233,218,513
14.	Repairs	13,856,075	26,166,958	17,169,314	6,811,690				1,591,330	1,315,658	66,911,025
15.	Bad Debts	368,873	9,771,831							734,279	10,874,983
16.	Rents	15,912,947	37,302,422	4,010,460	6,283		4,474		689,490	1,574,377	59,500,453
17.	Taxes	85,359,170	25,902,939	13,771,709	133,434				1,600,829	1,332,176	128,100,257
18.	Interest	69,021	227,631	26,083					29	13,548,347	13,871,111
19.	Contributions	58,523	67,709	16,081					2,755	5,433,007	5,578,075
20.	Casualty or Theft Losses	2,442,650	568,856	966,548	9,647				74,435		4,062,136
21.	Amortization	225,480	2,139,230							23,430	2,388,140
22.	Depreciation	102,095,097	49,056,747	43,344,901	13,848,401				6,640,583	3,594,429	218,580,158
23.	Depletion	233,200,000									233,200,000
24.	Advertising	17,260	23,429,890	22,993					656,612		24,126,755
25.	(a) Pension, profit-sharing, etc. Plans	7,157,175	8,494,198	9,908,527	1,592,857				422,167	2,497,430	30,072,354
	(b) Other Employee Benefit Plans	5,824,221	6,339,674	5,710,105	759,875				471,870	4,896,210	24,001,955
26.	Other Deductions	257,596,255	836,340,676	35,007,270	3,093,736	3,826,329	199,526	234,200	39,031,727	(34,318,225)	1,141,011,494
27.	Total Deductions	$763,020,113	$1,126,538,784	$ 191,537,713	$ 29,819,185	$3,826,329	$204,000	$234,200	$ 57,630,926	$ 24,174,499	$2,196,985,748
28.	Federal Taxable Income - Before HOLD & Special Deductions	$144,291,667	$ 47,751,861	$ 71,576,470	$ 8,273,247	($3,826,329)	($204,000)	$298,257	$ 17,665,877	$ 749,113	$ 286,576,163
29.	Less: (a) HOLD									16,390,584	16,390,584
	(b) Special Deductions	16	647								663
30.	Federal Taxable Income	* $144,291,651	$ 47,751,214	$ 71,576,470	$ 8,273,247	($3,826,329)	($204,000)	$298,257	$ 17,665,877	($ 15,641,471)	$ 270,184,916

* Special Note: This Exploration & Production Functional Net Income Figure Was Adopted In The Wisconsin Audit (Exhibit E-4.1, Page 17) To Compute Adjusted Departmental Net Income.

A. 762

HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
1967 Federal Taxable Income

Schedule B - 1967
Page 1 of 1

Line No.		Functional Operating Departments: Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total
1	Gross Receipts	$1,093,783,532	$3,030,095,828	$2,740,032,660	$111,538,886	$	$	$ 193,258	($2,573,070,668)	$4,402,573,496
2	Less: Cost of Goods Sold	77,046,458	1,819,537,086	2,481,078,874	71,686,229				(2,568,985,102)	1,880,363,545
3	Gross Profit	$1,016,737,074	$1,210,558,742	$ 258,953,786	$ 39,852,657	$	$	$ 193,258	($ 4,085,566)	$2,522,209,951
4	Dividends	56	390						18,100,000	18,100,446
5	Interest - U.S. Obligations	1,250							2,195,792	2,197,042
6	Other Interest	124,751	1,518,820	12,167		2,492		685,963	896,918	3,241,111
7	Gross Rents		49,987,325	1,163,365					1,173,438	52,324,128
8	Gross Royalties	162,069	1,375							163,444
9	Net Gains/(Losses)	664,260	37,284	81,573	(10,366)			799,507	874,115	2,446,373
10	Other Income	25,532,132	24,152,071	47,403,807	163,334				3,783,636	101,034,980
11	Total Income	$1,043,221,592	$1,286,256,007	$ 307,614,698	$ 40,005,625	$ 2,492	$	$ 1,678,728	$ 22,938,333	$2,701,717,475
12	Compensation of Officers	$	$	$	$	$	$	$	$ 1,378,382	$ 1,378,382
13	Salaries and Wages	53,516,561	112,685,659	58,398,537	3,609,081	284,241	325,016		28,310,996	257,330,291
14	Repairs	19,882,936	31,036,400	23,352,442	4,904,638			50,294	1,507,103	80,733,813
15	Bad Debts	85,128	10,319,901	1,102					737,080	11,143,211
16	Rents	14,108,284	43,828,065	4,378,017	6,483	146,723	29,069		2,045,123	64,541,764
17	Taxes	81,517,925	28,548,073	14,157,546	160,820	23,420	915	386,900	1,078,696	125,874,295
18	Interest	24,215	714,324	47,070		4,195		726,747	3,634,058	5,150,609
19	Contributions	66,826	28,266	1,849				1,004,089	1,766,814	2,867,844
20	Casualty or Theft Losses	2,549,690	410,155	527,409						3,487,254
21	Amortization	244,703	2,385,683	301					24,031	2,655,718
22	Depreciation	108,405,186	50,117,020	33,382,703	13,547,631	12,420	15,952	1,143,121	3,576,229	210,200,262
23	Depletion	265,400,000								265,400,000
24	Advertising		28,218,467	49,709				17,134		28,285,310
25	(a) Pension, Profit-Sharing Etc. Plans	5,768,526	7,377,145	6,977,761	1,324,315	24,217	23,798		2,518,584	24,014,346
	(b) Other Employee Benefit Plans	3,660,054	5,720,435	5,454,449	1,070,860	7,315	10,320		6,614,634	22,538,067
26	Other Deductions	273,762,559	903,337,085	70,124,153	4,731,740	7,084,446	2,334,175	188,999	(36,406,080)	1,227,157,077
27	Total Deductions	$ 828,992,593	$1,226,727,878	$ 217,053,048	$ 29,355,568	$7,586,977	$2,739,245	$3,517,284	$ 16,785,650	$2,332,758,243
28	Federal Taxable Income - Before HOLD & Special Deductions	$ 214,228,999	$ 59,528,129	$ 90,561,650	$ 10,650,057	($7,584,485)	($2,739,245)	($1,838,556)	$ 6,152,683	$ 368,959,232
29	Less: (a) HOLD								6,686	6,686
	(b) Special Deductions	48	332						15,385,000	15,385,380
30	Federal Taxable Income	* $ 214,228,951	$ 59,527,797	$ 90,561,650	$ 10,650,057	($7,584,485)	($2,739,245)	($1,838,556)	($ 9,239,003)	$ 353,567,166

* Special Note: This Exploration & Production functional net income figure was adopted in the Wisconsin audit (Exhibit E-4.1, Page 17) to compute adjusted departmental net income.

A. 763

HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
1967 Federal Taxable Income

Schedule B - 1967
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Line No.		Functional Operating Departments: Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total
1	Gross Receipts	$1,093,783,532	$3,030,095,828	$2,740,032,660	$111,538,886	$	$	$ 193,258	($2,573,070,668)	$4,402,573,496
2	Less: Cost of Goods Sold	77,046,458	1,819,537,086	2,481,078,874	71,686,229				(2,560,985,102)	1,880,363,545
3	Gross Profit	$1,016,737,074	$1,210,558,742	$ 258,953,786	$ 39,852,657	$	$	$ 193,258	($ 4,085,566)	$2,522,209,951
4	Dividends	56	390						18,100,000	18,100,446
5	Interest - U.S. Obligations	1,250							2,195,792	2,197,042
6	Other Interest	124,751	1,518,820	12,167		2,492		685,963	896,918	3,241,111
7	Gross Rents		49,987,325	1,163,365					1,173,438	52,324,128
8	Gross Royalties	162,069	1,375							163,444
9	Net Gains/(Losses)	664,260	37,284	81,573	(10,366)			799,507	874,115	2,446,373
10	Other Income	25,532,132	24,152,071	47,403,807	163,334				3,783,636	101,034,980
11	Total Income	$1,043,221,592	$1,286,236,007	$ 307,614,698	$ 40,005,625	$ 2,492	$	$ 1,678,728	$ 22,938,333	$2,701,717,475
12	Compensation of Officers	$	$	$	$	$	$	$	$ 1,378,382	$ 1,378,382
13	Salaries and Wages	53,516,561	112,685,859	58,598,537	3,609,081	284,241	325,016		28,310,996	257,330,291
14	Repairs	19,882,936	31,036,400	23,352,442	4,904,638			50,294	1,507,103	80,733,813
15	Bad Debts	85,128	10,319,901	1,102					737,080	11,143,211
16	Rents	14,108,284	43,828,065	4,378,017	6,483	146,723	29,069		2,045,123	64,541,764
17	Taxes	81,517,925	28,548,073	14,157,546	160,820	23,420	915	386,900	1,078,696	125,874,295
18	Interest	24,215	714,324	47,070		4,195		726,747	3,634,058	5,150,609
19	Contributions	66,826	28,266	1,849				1,004,089	1,766,814	2,867,844
20	Casualty or Theft Losses	2,549,690	410,155	527,409						3,487,254
21	Amortization	244,703	2,386,683	301					24,031	2,655,718
22	Depreciation	108,405,186	50,117,020	33,382,703	13,547,631	12,420	15,952	1,143,121	3,576,229	210,200,262
23	Depletion	265,400,000								265,400,000
24	Advertising		28,218,467	49,709				17,134		28,285,310
25	(a) Pension, Profit-Sharing Etc. Plans	5,768,526	7,377,145	6,977,761	1,324,315	24,217	23,798		2,518,584	24,014,346
	(b) Other Employee Benefit Plans	3,660,054	5,720,435	5,454,449	1,070,860	7,315	10,320		6,614,634	22,538,067
26	Other Deductions	273,762,559	905,337,085	70,124,153	4,731,740	7,084,446	2,334,175	188,999	(36,406,080)	1,227,157,077
27	Total Deductions	$ 828,992,593	$1,226,727,878	$ 217,053,048	$ 29,355,568	$7,586,977	$2,739,245	$3,517,284	$ 16,785,650	$2,332,758,243
28	Federal Taxable Income - Before NOLD & Special Deductions	$ 214,228,999	$ 59,528,129	$ 90,561,650	$ 10,650,057	($7,584,485)	($2,739,245)	($1,838,556)	$ 6,152,683	$ 368,959,232
29	Less: (a) NOLD								6,686	6,686
	(b) Special Deductions	48	332						15,385,000	15,385,380
30	Federal Taxable Income	*$ 214,228,951	$ 59,527,797	$ 90,561,650	$ 10,650,057	($7,584,485)	($2,739,245)	($1,838,556)	($ 9,239,003)	$ 353,567,166

* Special Note: This Exploration & Production functional net income figure was adopted in the Wisconsin audit (Exhibit E-4.1, Page 17) to compute adjusted departmental net income.

A. 764

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
1968 Federal Taxable Income

Schedule B - 1968
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Line No.		Functional Operating Departments: Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total
1.	Gross Receipts	$1,182,864,191	$3,235,048,467	$2,863,537,827	$117,586,029	$	$	$ 341,365	($2,691,065,691)	$4,708,312,188
2.	Less: Cost Of Goods Sold	92,870,106	1,909,789,957	2,606,792,717	78,972,685				(2,690,342,608	1,998,082,857
3.	Gross Profit	$1,089,994,085	$1,325,258,510	$ 256,745,110	$ 38,613,344	$	$	$ 341,365	($ 723,083)	$2,710,229,331
4.	Dividends	75	413						11,793,000	11,793,488
5.	Interest-U.S. Obligations	625							352,295	352,920
6.	Other Interest	62,672	1,938,997	129,945	852			832,614	690,238	3,655,318
7.	Gross Rents		56,606,043	426,922					1,107,562	58,140,527
8.	Gross Royalties	75,952	1,037							76,989
9.	Net Gains/(Losses)	1,599,692	(64,120)	6,537	80,113	(97,093)		1,464,562	4,317,653	7,307,344
10.	Other Income	10,337,702	27,507,002	49,566,702	108,529	13,463		(25,545)	4,027,595	91,535,448
11.	Total Income	$1,102,070,803	$1,411,247,882	$ 306,875,216	$ 38,802,838	($ 83,630)	$	$2,612,996	$ 21,565,260	$2,883,091,365
12.	Compensation Of Officers	$	$	$	$	$	$	$	$ 1,285,259	$ 1,285,259
13.	Salaries And Wages	43,948,622	110,673,839	63,828,313	2,676,420	312,122	669,141		32,141,318	254,249,775
14.	Repairs	19,031,028	29,388,592	21,709,144	5,885,416		6,951		1,503,627	77,524,758
15.	Bad Debts	125,150	13,034,033	2,908	406,986				734,279	14,303,356
16.	Rents	14,935,851	46,528,929	5,302,683	4,353,225	116,486	248,980		4,799,931	76,286,085
17.	Taxes	87,280,436	32,348,834	15,660,205	208,819	22,041	39,648	328,963	1,095,453	136,984,419
18.	Interest	21,417	722,179	30,285	3,337	35,931		326,655	11,886,124	13,025,928
19.	Contributions	1,294,352	70,312	(7,676)				318,679	10,590,500	12,266,167
20.	Casualty Or Theft Losses	1,935,812	703,515	1,087,981	942,231			984		4,670,523
21.	Amortization	281,738	2,457,757					66,728	25,362	2,831,585
22.	Depreciation	116,099,483	57,171,726	50,039,957	6,833,915	37,583	49,583	813,387	3,190,366	234,236,000
23.	Depletion	285,000,000								285,000,000
24.	Advertising		26,967,350	17,170						26,984,520
25.	(a) Pension, Profit-Sharing, ETC. Plans	4,809,249	6,210,984	5,997,590	1,080,897	22,318	34,075		2,332,179	20,487,292
	(b) Other Employee Benefit Plans	4,451,308	6,506,528	6,518,427	637,099	13,216	24,447		6,521,038	24,672,063
26.	Other Deductions	286,080,826	960,193,443	77,127,969	6,572,840	6,635,915	4,287,757	307,442	(52,497,326)	1,288,708,866
27.	Total Deductions	$ 865,295,272	$1,292,978,021	$ 247,314,956	$ 29,601,185	$7,195,632	$5,360,582	$ 2,162,838	$ 23,608,110	$2,473,516,596
28.	Federal Taxable Income-Before NOLD And Special Deductions	$ 236,775,531	$ 118,269,861	$ 59,560,260	$ 9,201,653	($7,279,262)	($5,360,582)	$ 450,158	($ 2,042,850)	$ 409,574,769
29.	Less: (a) NOLD								10,024,050	10,024,465
	(b) Special Deductions	64	351							
30.	Federal Taxable Income	*$ 236,775,467	$ 118,269,510	$ 59,560,260	$ 9,201,653	($7,279,262)	($5,360,582)	$ 450,158	($ 12,066,900)	$ 399,550,304

* Special Note: This Exploration & Production Functional Net Income Figure Was Adopted In The Wisconsin Audit (Exhibit E-4.1, Page 17) To Compute Adjusted Departmental Net Income

A. 765

HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
Reconciliation of 1965 Federal Taxable Income With 1965 Wisconsin Adjusted Net Income

Schedule C - 1965
Page 1 Of 4

	Functional Operating Departments							
	Exploration & Production	Marketing	Refining	Marine	Enjay	Administrative	Total	
Federal Taxable Income - Before Special Deductions	$ 84,961,341	$82,724,995	$12,156,234	$ 5,859,819	$23,487,749	$3,028,094	$212,218,232	From Line 28, Schedule B
Adjustments:								
Contributions Deducted	2,513,531	795,427	37,611	1,090	2,511	1,952,654	5,302,824	
Municipal Interest Deducted			136			131,585	131,721	
Percentage Depletion Deducted	210,200,000						210,200,000	
Depreciation & Amortization Deducted	95,989,108	44,310,867	52,031,551	13,586,533	15,119,269	4,807,535	225,844,863	
Allowable Depreciation & Amortization	(94,303,000)	(44,850,000)	(57,270,000)	(11,525,000)	(25,230,000)	(2,915,683)	(236,093,683)	
Allowable Cost Depletion	(9,129,210)						(9,129,210)	
Bad Debts		280,801		69,836	2,582,350	734,093	3,667,080	
COPP - Proceeds	(49,877,000)						(49,877,000)	
COPP - Repayments	51,634,169						51,634,169	
Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deductions)	$291,988,939	$ 83,262,090	$ 6,955,532	$ 7,992,278	$15,961,879	$7,738,278	$413,898,996	
Federal Income Tax Deductible							(6,817,243)	
Contributions Deductible							(3,487,101)	
Adjusted Net Income - Wisconsin Basis							$403,594,652	
Net Allocable (Income)/Loss Exploration & Production Dept.						($283,992,769)		
Other Net Allocable (Income)/ Loss						(15,544,522)	(299,537,291)	From Page 2
Apportionable Income							$104,057,361	
Percent to Wisconsin-(Per Page 3)							.3954%	
Net Income Apportioned to Wisconsin							$ 411,443	
Wisconsin Allocable Income/(Loss)							(100,602)	
Wisconsin Net Taxable Income - (Excluding Exploration & Production And Other Allocable Net Income Or Loss)							$ 310,841	To Schedule A
Tax:								
On 1st $6,000 - $225							225	
On Excess - 7%							21,339	
Total Tax							21,564	To Schedule A

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HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
1965 Net Allocable Income

Schedule C - 1965
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	Functional Operating Departments							
	Exploration & Production	Marketing	Refining	Marine	Enjay	Administrative	Total	
Income Which Follows Residence of Taxpayer								
Dividend Income	$ 146,388	$ 382	$	$	$	$15,833,433	$ 15,980,203	
Interest Income	179,056	986,259	242	1,501	531,113	5,722,405	7,420,576	
Interest Expense	(178,699)	(192,107)	(11,501)		(70)	(5,301,048)	(5,683,425)	
Net Dividends & Interest Income	$ 146,745	$794,534	($ 11,259)	$ 1,501	$531,043	$16,254,790	$ 17,717,354	
Royalties - Net	188,775	1,210				1,907	191,892	
Sub-Total	$ 335,520	$795,744	($ 11,259)	$ 1,501	$531,043	$16,256,697	$ 17,909,246	
Income Which Follows Situs of Property								
Income (Losses) - Other Than Departmental								
Gains/(Losses) On Sales Of Assets	$ 5,571,653	($ 56,432)	$ 151,267	($139,300)	($ 76,495)	$ 634,453	$ 6,085,146	
Casualty Losses-Fixed Assets	(98,638)	(98,488)	(495)		12,237		(185,384)	
Plant & Equipment-Retirement Losses	(779,993)	(791)	(2,922,953)	(704)	(100,984)	(36,980)	(3,842,405)	
Material Disposal Gains/(Losses)	(118,706)	(120,847)	107,732	(517)	3,157		(129,181)	
Gain On Sale Of Stock Material	34,159	(1,072)					33,087	
Land Sales		415,472					415,472	
Departmental Allocable Income/(Loss)								
Exploration & Production And Other Situs Operations - Net Income On Wisconsin Basis (Before FIT & Contributions Deduction)- Less Other Allocable Income	287,044,944						287,044,944	
Marine Department Charter Revenue				500,000			500,000	
Sub-Total	$291,653,419	$137,842	($2,664,449)	$359,479	($162,085)	$ 597,473	$289,921,679	
Total Allocable Income/(Loss)	$291,988,939	$933,586	($2,675,708)	$360,980	$368,958	$16,854,170	$307,830,925	
* Adjustment For Administrative Department Expense	(684,565)	(2,189)	6,273	(846)	(865)	(39,515)	(721,707)	
Allocable Income/(Loss)-Before FIT Deduction	$291,304,374	$931,397	($2,669,435)	$360,134	$368,093	$16,814,655	$307,109,218	
Federal Income Taxes	(4,798,074)	(15,341)	43,968	(5,932)	(6,063)	(276,954)	(5,058,396)	
Allocable Income-Before Contributions	$286,506,300	$916,056	($2,625,467)	$354,202	$362,030	$16,537,701	$302,050,822	
Exploration & Production And Other Situs Operations Contributions	(2,513,531)						(2,513,531)	
Net Allocable Income/(Loss)	$283,992,769	$916,056	($2,625,467)	$354,202	$362,030	$16,537,791	$299,537,291 (1)	To Page 1
(1) Exploration & Production Department Net Allocable Income	$283,992,769							
Other Net Allocable Income or (Loss)	15,544,522							
Net Allocable Income/(Loss)	$299,537,291							
* Percent Of Administrative Department Expense	70.5459%	.2256%	(.6465%)	.0872%	4.0721%	.0891%	74.3734%	From Page 4

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HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
Calculation of 1965 Apportionment Factor

	12/31/64		12/31/65	
	Wisconsin	Total	Wisconsin	Total
I. Total Net Tangible Property - Per Books	$11,486,028	$3,113,837,517	$12,027,654	$3,245,702,266
Adjustments:				
1. Net Tangible Property - Exploration & Production and Other Situs Operations		(1,679,834,663)		(1,706,583,851)
2. Incomplete Construction - Other than Exploration & Production and Other Situs Operations	(630,669)	(50,662,052)	(415,118)	(71,479,381)
3. Marine Department Net Tangible Property Applicable to Allocable Charter Income		(2,400,000)		(4,700,000)
Totals - End of Year	$10,855,359	$1,380,940,802	$11,612,536	$1,462,939,034
Totals Beginning of Year			10,855,35[illegible]	1,380,940,802
Combined Totals			$22,467,89[illegible]	$2,843,879,836
Average			$11,233,94[illegible]	$1,421,939,918
Percent to Wisconsin			.7900%	
II. Cost of Manufacturing			$ -0-	$2,273,000,657
Percent to Wisconsin			.0000%	
III. Total Sales - Per Wisconsin and Federal Returns			$12,987,634	$4,070,986,858
Adjustments:				
1. Sales - Exploration & Production and Other Situs Operations				(882,627,759)
2. Interdepartmental Sales - Exploration & Production and Other Situs Operations				703,131,971
3. Taxes on Products Sold				(604,793,382)
4. Cash Discounts				(3,518,128)
5. Allocable Marine Department Charter Revenue				(6,390,322)
6. Additional Wisconsin Sales			(7,490)	
Totals - Adjusted Sales			$12,980,144	$3,276,789,238
Percent to Wisconsin			.3961%	
Total Percents			1.1861%	
Average Percent			.3954%	

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HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
Adjustment For Administrative Department Expenses And Federal Income Tax Deduction Assignable to Allocable Income

I. A. Total Allocable Income	$307,830,925	
B. Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	$413,898,996	
C. Ratio Of A to B	74.3734%	To Page 2
Administrative Department Net Loss From Operations - Per Books	$ 970,383	
Ratio (I. C Above)	74.3734%	
Administrative Department Expenses Attributable To Allocable Income	$ 721,707	
II. A. Federal Income Tax Deductible	$ 6,817,2[illegible]3	
B. Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	$413,898,[illegible]96	
C. Ratio Of A To B	1.6471%	

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HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
Reconciliation of 1966 Federal Taxable Income With 1966 Wisconsin Adjusted Net Income

Schedule C - 1966
Page 1 Of 4

	Functional Operating Departments										
	Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Enjoy	Administrative	Total	
Federal Taxable Income Before Special Deductions	$144,291,667	$47,751,861	$71,576,470	$ 8,273,267	($3,826,329)	($204,000)	$298,257	$17,665,877	$ 749,113	$386,376,163	From Line 28, Schedule B
Adjustments:											
Contributions Deducted	58,523	67,709	16,081							3,370,073	
Municipal Interest Deducted			135					2,735	5,433,007	418,930	
Percentage Depletion Deducted	233,300,000								416,783	233,300,000	
Depreciation & Amortization Deducted	102,320,577	51,195,977	43,344,901	13,048,401						270,968,298	
Allowable Depreciation & Amortization	(102,316,000)	(49,371,000)	(48,326,000)	(12,096,000)				6,640,383	3,617,030	(229,565,919)	
Allowable Cost Depletion	(15,994,658)							(14,485,919)	(3,051,000)	(15,994,658)	
Bad Debts	300,000	3,564,368		(60,036)						465,729	
COPP - Proceeds	(41,124,000)							(4,293,118)	806,246	(41,124,000)	
COPP - Repayments	56,482,131									56,482,131	
Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deductions)	$377,236,318	$53,208,885	$66,611,367	$ 9,165,632	($3,826,329)	($204,000)	$298,257	$ 3,638,378	$7,974,618	$316,864,728	
Federal Income Tax Deductible										(42,638,756)	
Contributions Deductible										(3,378,873)	
Adjusted Net Income-Wisconsin Basis										$468,647,897	
Net Allocable (Income)/Loss											
Exploration & Production Department										($364,044,538)	
Other Net Allocable (Income)/Loss										(8,332,744)	(352,377,282) From Page 3
Apportionable Income										$116,270,615	
Percent to Wisconsin - (Per Page 3)										.43765	
Net Income Apportioned to Wisconsin										$ 508,880	
Wisconsin Allocable Income/(Loss)										(62,280)	
Wisconsin Net Taxable Income -(Excluding Exploration & Production And Other Allocable Net Income Or Loss)										$ 443,520	To Schedule A
Tax:											
On 1st 6,000 - 4%										$ 239	
On Excess - 7%										30,638	
Total Tax										$ 30,851	To Schedule A

HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
1966 Net Allocable Income

Schedule C - 1966
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	Functional Operating Departments									
	Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Enjoy	Administrative	Total
Income Which Follows Residence of Taxpayer										
Dividend Income	$ 19	$ 761	$	$	$	$	$		$19,283,040	$ 19,283,820
Interest Income	153,048	1,146,990	51,955	1,837				74,975	6,364,991	7,743,796
Interest Expense	(69,021)	227,631)	(26,083)						(13,548,347)	(13,871,111)
Net Dividends & Interest Income	$ 84,046	$ 920,120	$ 25,872	$ 1,837	$	$	$	$ 29)	$12,099,684	$ 13,156,505
Royalties - Net	233,715	1,102						$24,946	622	235,439
Sub-Total	$ 317,761	$ 921,222	$ 25,872	$ 1,837	$	$	$	$24,946	$12,100,306	$ 13,391,944
Income Which Follows Situs of Property										
Income/(Losses)-Other Than Departmental										
Gains/(Losses) Sales Of Assets	($ 4,405,509)	($ 157,229)	$ 2,987	$ 27,086				$ 222	$ 658,398	($ 3,874,045)
Casualty Losses-Fixed Assets	(301,612)	(69,746)	(533)	(9,647)				(91)		(381,629)
Plant & Equipment-Retirement Losses	(1,811,076)	(190,047)	(1,119,568)					(23,259)		(3,143,950)
Material Disposal Gains/(Losses)	(365,984)	(80,535)	(40,971)	(6,654)				5,871		(488,273)
Land Sales										
Gain on Sale of Stock Material	9,381	(6,787)								2,594
Departmental Allocable Income/(Loss)										
Exploration & Production and Other Situs Operations-Net Income On Wisconsin Basis (Before FIT & Contributions Deduction)-	383,793,357				(3,826,329)	(204,000)	(298,257)			379,464,771
Less Other Allocable Income				1,400,000						1,400,000
Marine Department Charter Revenue										
Sub-Total	$376,918,557	($ 504,344)	($1,158,085)	$1,410,785	($3,826,329)	($204,000)	($298,257)	($17,257)	$ 658,398	$372,979,468
Total Allocable Income/(Loss)	$377,236,318	$ 416,878	($1,132,213)	$1,412,622	($3,826,329)	($204,000)	($298,257)	$ 7,689	$12,758,704	$386,371,412
*Adjustment For Administrative Department Expense	(2,194,154)	(2,426)	6,587	(8,216)	22,256	1,186	1,735	(45)	(74,210)	(2,247,287)
Allocable Income/(Loss)-Before FIT Deduction	$375,042,164	$ 414,452	($1,125,626)	$1,404,406	($3,804,073)	($202,814)	($296,522)	$ 7,644	$12,684,494	$384,124,125
Federal Income Taxes	(30,939,103)	(34,190)	92,859	(115,856)	313,816	16,730	24,462	(631)	(1,046,407)	(31,688,320)
Allocable Income-Before Contributions	$344,103,061	$ 380,262	($1,032,767)	$1,288,550	($3,490,257)	($186,084)	($272,060)	$ 7,013	$11,638,087	$352,435,805
Less Exploration & Production And Other Situs Operations Contributions	(58,523)									(58,523)
Net Allocable Income/(Loss)	$344,044,538	$ 380,262	($1,032,767)	$1,288,550	($3,490,257)	($186,084)	($272,060)	$ 7,013	$11,638,087	$352,377,282 (1) To Page 1
(1) Exploration & Production Department Net Allocable Income	$344,044,538									
Other Net Allocable Income/(Loss)	8,332,744									
Net Allocable Income/(Loss)	$352,377,282									
*Percent Of Administrative Department Expense	72.9855%	.0807%	(.2191%)	.2733%	(.7403%)	(.0395%)	(.0577%)	.0015%	2.4685%	74.7529% From Page 4

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HUMBLE OIL & REFINING COMPANY

Schedule C - 1966
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1965-1968 Wisconsin Corporation Franchise Tax Audit
Calculation of 1966 Apportionment Factor

	12/31/65		12/31/66	
	Wisconsin	Total	Wisconsin	Total
I. Total Net Tangible Property - Per Books	$12,027,654	$3,245,702,266	$14,378,381	$3,243,630,952
Adjustments:				
1. Net Tangible Property - Exploration & Production and Other Situs Operations		(1,706,583,851)		(1,744,405,245)
2. Incomplete Construction - Other than Exploration & Production and Other Situs Operations	(415,118)	(71,479,381)	(921,250)	(74,372,637)
3. Marine Department Net Tangible Property Applicable to Allocable Charter Income		(4,700,000)		(4,700,000)
Totals - End of Year	$11,612,536	$1,462,939,034	$13,457,131	$1,420,153,070
Totals - Beginning of Year			11,612,536	1,462,939,034
Combined Totals			$25,069,667	$2,883,092,104
Average			$12,534,834	$1,441,546,052
Percent to Wisconsin			.8695%	
II. Cost of Manufacturing			$ -0-	$2,260,452,811
Percent to Wisconsin			.0000%	
III. Total Sales - Per Wisconsin and Federal Returns			$14,050,904	$4,095,866,931
Adjustments:				
1. Sales - Exploration & Production and Other Situs Operations				(974,831,438)
2. Interdepartmental Sales - Exploration & Production and Other Situs Operations				750,964,073
3. Taxes on Products Sold				(621,275,049)
4. Cash Discounts				(3,884,188)
5. Allocable Marine Department Charter Revenue				(7,815,671)
6. Additional Wisconsin Sales			307,155	
Totals - Adjusted Sales			$14,358,059	$3,239,024,658
Percent to Wisconsin			.4433%	
Total Percents			1.3128%	
Average Percent			.4376%	To Page 1

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HUMBLE OIL & REFINING COMPANY

Schedule C - 1966
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1965-1968 Wisconsin Corporation Franchise Tax Audit
Adjustment for Administrative Department Expenses and
Federal Income Tax Deduction Assignable to Allocable Income

I. A. Total Allocable Income	$386,371,412
B. Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	$516,864,728
C. Ratio of A to B	74.7529% To Page 2
Administrative Department Net Loss From Operations - Per Books	$ 3,006,287
Ratio (I. C. above)	74.7529%
Administrative Department Expenses Attributable to Allocable Income	$ 2,247,287
II. A. Federal Income Tax Deductible	$ 42,638,820
B. Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	$516,864,728
C. Ratio of A to B	8.2495%

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HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
Reconciliation of 1967 Federal Taxable Income with 1967 Wisconsin Adjusted Net Income

Schedule C - 1967
Page 1 of 4

	Functional Operating Departments									
	Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total	
Federal Taxable Income Before Special Deductions	$216,228,999	$30,530,129	$90,561,650	$10,650,057	($7,564,483)	($3,730,245)	($1,636,556)	$6,152,683	$340,950,232	From Line 20, Schedule B
Adjustments:										
Contributions Deducted	66,826	38,366	1,849				1,004,000	1,766,814	2,867,844	
Municipal Interest Deducted			135				51,497	548,415	600,047	
Percentage Depletion Deducted	265,400,000								265,400,000	
Depreciation & Amortization Deducted	108,649,589	32,503,703	33,303,004	13,567,631	12,420	15,952	1,143,121	3,600,360	232,655,980	
Allowable Depreciation & Amortization	(107,657,000)	(56,094,000)	(61,766,000)	(12,429,000)	(20,000)	(12,000)	(710,000)	(2,371,730)	(241,359,730)	
Allowable Cost Depletion	(13,863,282)								(13,863,282)	
Bad Debts	(125,504)	4,081,882						808,053	4,764,430	
CDPP - Proceeds	(38,710,000)								(38,710,000)	
CDPP - Expenses	43,843,737								43,843,737	
Adjusted Net Income - Wisconsin Basis (Before FIT & Contribution Deductions)	$471,833,685	$9,347,979	$62,190,638	$11,766,688	($7,592,065)	($2,735,293)	$ 150,151	$10,304,998	$485,350,286	
Federal Income Tax Deductible Contributions Deductible									(60,535,629)	
Adjusted Net Income - Wisconsin Basis									(2,867,844)	
Net Allocable (Income)/Loss									$422,954,613	
Exploration & Production Department									($423,222,780)	
Other Net Allocable (Income)/Loss									(9,011,398)	
Apportionable Income									(432,234,187)	From Page 2
Percent to Wisconsin--(For Page 3)									$189,720,426	
Net Income Apportioned to Wisconsin									.44715	
Wisconsin Allocable Income/(Loss)									$ 530,059	
Wisconsin Net Taxable Income-- (Excluding Exploration & Production and Other Allocable Net Income or Loss)									(28,077)	
Tax:									$ 502,182	To Schedule A
On First $6,000 -- 3%									$ 323	
On Excess -- 7%									34,803	
Total Tax									$ 35,126	To Schedule A

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HUMBLE OIL & REFINING COMPANY

Schedule C - 1967
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1965 - 1968 Wisconsin Corporation Franchise Tax Audit
1967 Net Allocable Income

	Functional Operating Departments								
	Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total
Income Which Follows Residence of Taxpayer									
Dividend Income	$ 56	$ 390	$	$	$	$	$	$18,100,000	$ 18,100,446
Interest Income	126,001	1,518,820	12,302		2,492		737,460	3,641,125	6,038,200
Interest Expense	(24,215)	(714,324)	(47,070)		(4,195)		(726,747)	(3,434,058)	(5,150,609)
Net Dividends And Interest Income	($ 101,842	$ 804,886	($ 34,768)	$	($ 1,703)	$	$ 10,713	$18,107,067	$ 18,988,037
Royalties - Net	162,069	1,375							163,444
Sub-Total	$ 263,911	$ 806,261	($ 34,768)	$	($ 1,703)	$	$ 10,713	$18,107,067	$ 19,151,481
Income Which Follows Situs Of Property									
Income/(Losses)-Other Than Departmental									
Gains/(Losses) On Sale Of Assets	$ 664,260	$ 37,284	$ 81,573	($ 10,366)	$	$	$ 799,507	$ 874,115	$ 2,446,373
Casualty Losses-Fixed Assets	(271,554)	(25,019)	(1,465)						(298,038)
Plant And Equipment-Retirement Losses	(1,832,719)	(446)	(1,353,393)						(3,186,558)
Land Sales									
Gain On Sale Of Stock Material	35,380	(10,125)							25,255
Material Disposal Gains/(Losses)	(514,121)	7,929	(237,717)	368					(743,541)
Departmental Allocable Income									
Exploration & Production And Other Situs Operations - Net Income On Wisconsin Basis (Before FIT And Contributions Deduction) - Less Other Allocable Income	473,488,528				(7,590,362)	(2,735,293)	(660,069)		462,502,804
Marine Department Charter Revenue				3,100,000					3,100,000
Sub-Total	$471,569,774	$ 9,623	($1,511,002)	$3,090,002	($7,590,362)	($2,735,293)	$ 139,438	$ 874,115	$463,846,295
Total Allocable Income/(Loss)	$471,833,685	$ 815,884	($1,545,770)	$3,090,002	($7,592,065)	($2,735,293)	$ 150,151	$18,981,182	$482,997,776
*Adjustment For Administrative Department Expense	(1,511,890)	(2,615)	4,952	(9,900)	24,326	8,766	(481)	(60,821)	(1,547,663)
Allocable Income/(Loss) - Before FIT Deduction	$470,321,795	$ 813,269	($1,540,818)	$3,080,102	($7,567,739)	($2,726,527)	$ 149,670	$18,920,361	$481,450,113
Federal Income Taxes	(47,032,180)	(81,327)	154,082	(308,010)	756,774	272,653	(14,967)	(1,892,036)	(48,145,011)
Allocable Income Before Contributions	$423,289,615	$ 731,942	($1,386,736)	$2,772,092	($6,810,965)	($2,453,874)	$ 134,703	$17,028,325	$433,305,102
Exploration & Production And Other Situs Operations Contributions	(66,826)						(1,004,089)		(1,070,915)
Net Allocable Income/(Loss)	$423,222,789	$ 731,942	($1,386,736)	$2,772,092	($6,810,965)	($2,453,874)	($ 869,386)	$17,028,325	$432,234,187 (1) To Page 1
(1) Exploration & Production Department Net Allocable Income	$423,222,789								
Other Net Allocable Income or (Loss)	9,011,398								
Net Allocable Income/(Loss)	$432,234,187								
*Percent Of Administrative Department Expense	77.9429%	.1348%	(.2553%)	.5104%	(1.2541%)	(.4519%)	.0248%	3.1355%	79.7871% From Page 4

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HUMBLE OIL & REFINING COMPANY

Schedule C-1967
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1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Calculation Of 1967 Apportionment Factor

	12/31/66		12/31/67	
	Wisconsin	Total	Wisconsin	Total
I. Total Net Tangible Property-Per Books	$14,378,381	$3,243,630,952	$15,718,233	$3,520,220,731
Adjustments:				
1. Net Tangible Property-Exploration & Production And Other Situs Operations		(1,744,405,245)		(1,845,287,774)
2. Incomplete Construction-Other Than Exploration & Production And Other Situs Operations	(921,250)	(74,372,637)	(259,200)	(127,472,028)
3. Marine Department Net Tangible Property Applicable to Allocable Charter Income		(4,700,000)		(2,400,000)
Totals - End Of Year	$13,457,131	$1,420,153,070	$15,459,033	$1,545,060,929
Totals - Beginning Of Year			13,457,131	1,420,153,070
Combined Totals			$28,916,164	$2,965,213,999
Average			$14,458,082	$1,482,607,000
Percent To Wisconsin			.9752%	
II. Cost Of Manufacturing			$	$2,481,078,874
Percent To Wisconsin			.0000%	
III. Total Sales-Per Wisconsin And Federal Returns			$16,281,720	$4,402,573,496
Adjustments:				
1. Sales-Exploration & Production And Other Situs Operations				(1,093,976,790)
2. Interdepartmental Sales-Exploration & Production And Other Situs Operations				831,899,537
3. Taxes On Products Sold				(677,457,213)
4. Cash Discounts				(4,284,102)
5. Allocable Marine Department Charter Revenue				(10,026,937)
6. Additional Wisconsin Sales			68,610	
Totals-Adjusted Sales			$16,350,330	$3,448,727,991
Percent To Wisconsin			.4741%	
Total Percents			1.4493%	
Average Percent			.4831%	To Page 1

A. 776

HUMBLE OIL & REFINING COMPANY

Schedule C - 196
Page 4 Of 4

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Adjustment For Administrative Department Expenses And Federal Income Tax Deduction Assignable To Allocable Income

I. A.	Total Allocable Income	$482,997,776
B.	Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	605,358,288
C.	Ratio Of A To B	79.7871% To Page 2
	Administrative Department Net Loss From Operations - Per Books	$ 1,939,741
	Ratio (I. C Above)	79.7871%
	Administrative Department Expenses Attributable To Allocable Income	$ 1,547,663
II. A.	Federal Income Tax Deductible	60,535,829
B.	Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	$605,358,288
C.	Ratio Of A To B	10.0000%

A. 777

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Reconciliation Of 1968 Federal Taxable Income With 1968 Wisconsin Adjusted Net Income

	Functional Operating Departments									
	Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total	
Federal Taxable Income-Before Special Deductions	$236,775,531	$118,269,861	$59,560,260	$9,201,653	($7,279,262)	($5,360,582)	$ 450,158	($ 2,042,850)	$409,574,769	From Line 28, Schedule B
Adjustments:										
Contributions Deducted	1,294,352	70,312	(7,676)				318,679	10,590,500	12,266,167	
Municipal Interest Deducted	331		135				47,500	3,066	51,032	
Percentage Depletion Deducted	285,000,000								285,000,000	
Depreciation And Amortization Deducted	116,381,221	59,629,483	50,039,957	6,833,915	37,583	49,583	880,115	3,215,728	237,067,585	
Allowable Depreciation And Amortization	(114,826,000)	(64,458,000)	(69,943,000)	(7,298,000)	(33,000)	(37,000)	(194,000)	(2,792,653)	(259,581,653)	
Allowable Cost Depletion	(16,793,795)								(16,793,795)	
Bad Debts	5,859	3,901,896						734,114	4,641,869	
COPP - Proceeds	(23,046,000)								(23,046,000)	
COPP - Repayments	40,015,573								40,015,573	
Adjusted Net Income-Wisconsin Basis (Before FIT And Contribution Deductions)	$524,807,072	$117,413,552	$39,649,676	$8,737,568	($7,274,679)	($5,347,999)	$1,502,452	$ 9,707,995	$689,195,547	
Federal Income Tax Deductible									(68,919,555)	
Contributions Deductible									(12,266,167)	
Adjusted Net Income - Wisconsin Basis									$608,009,825	
Net Allocable (Income)/Loss										
Exploration & Production Department									($467,810,179)	
Other Net Allocable (Income)/Loss									5,724,449	
Apportionable Income									(462,085,730)	From Page 2
Percent To Wisconsin - (Per Page 3)									$145,924,093	
Net Income Apportioned To Wisconsin									.45017	
Wisconsin Allocable Income/(Loss)									$ 656,804	
Wisconsin Net Taxable Income - (Excluding Exploration & Production And Other Allocable Net Income Or Loss)									43,282	
Tax:									$ 700,086	To Schedule A
On 1st $6,000 - $225									$ 212	
On Excess - 7%									48,599	
Total Tax									$ 48,811	To Schedule A

A. 778

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
1968 Net Allocable Income

	Functional Operating Departments								
	Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total
Income Which Follows Residence of Taxpayer									
Dividend Income	$ 75	$ 413	$	$	$	$	$	$11,793,000	$ 11,793,488
Interest Income	63,628	1,938,997	130,080	852			880,114	1,045,599	4,059,270
Interest Expense	(21,417)	(722,179)	(30,285)	(3,337)	(35,931)		(326,655)	(11,886,124)	(13,025,928)
Net Dividends And Interest Income	$ 42,286	$1,217,231	$ 99,795	($ 2,485)	($ 35,931)	$	$ 553,459	$ 952,475	$ 2,826,830
Royalties-Net	75,952	1,037							76,989
Sub-Total	$ 118,238	$1,218,268	$ 99,795	($ 2,485)	($ 35,931)	$	$ 553,459	$ 952,475	$ 2,903,819
Income Which Follows Situs Of Property									
Income/(Losses)-Other Than Departmental									
Gains/(Losses) On Sales Of Assets	$1,599,692	($ 64,120)	$ 6,537	$ 80,113	($ 97,093)	$	$1,464,362	$ 4,317,653	$ 7,307,344
Casualty Losses-Fixed Assets	(376,860)	(19,375)		(18,233)			(984)		(415,452)
Plant And Equipment-Retirement Loans	(1,905,110)	(2,951,193)	(1,176,259)						(6,032,562)
Material Disposal Gains/(Losses)	169,852	(14,826)	(356,316)	528					(200,762)
Land Sales									
Departmental Allocable Income/(Loss)									
Exploration & Production And Other Situs Operations-Net Income On Wisconsin Basis (Before FIT And Contributions Deduction)-Less Other Allocable Income	$25,201,260				(7,141,655)	(5,347,999)	(514,585)		$12,197,021
Marine Department Charter Revenue				3,000,000					3,000,000
Sub-Total	$524,688,834	($3,049,514)	($1,526,038)	$3,062,408	($7,238,748)	($5,347,999)	$ 948,993	$ 4,317,653	$515,855,589
Total Allocable Income/(Loss)	$524,807,072	($1,831,246)	($1,426,243)	$3,059,923	($7,274,679)	($5,347,999)	$1,502,452	$ 5,270,128	$518,759,408
*Adjustment For Administrative Department Expense	(3,579,815)	12,491	9,727	(20,873)	49,620	36,481	(10,248)	($ 35,945)	(3,538,562)
Allocable Income/(Loss)-Before FIT Deduction	$521,227,257	($1,818,755)	($1,416,516)	$3,039,050	($7,225,059)	($5,311,518)	$1,492,204	$ 5,234,183	$515,220,846
Federal Income Taxes	(52,122,726)	181,875	141,652	(303,905)	722,506	531,152	(149,221)	(523,418)	(51,522,085)
Allocable Income-Before Contributions	$469,104,531	($1,636,880)	($1,274,864)	$2,735,145	($6,502,553)	($4,780,366)	$1,342,983	$ 4,710,765	$463,698,761
Exploration & Production And Other Situs Operations Contributions	(1,294,352)						(318,679)		(1,613,031)
Net Allocable Income/(Loss)	$467,810,179	($1,636,880)	($1,274,864)	$2,735,145	($6,502,553)	($4,780,366)	$1,024,304	$ 4,710,765	$462,085,730 (1) To Page 1
(1) Exploration & Production Department Net Allocable Income	$467,810,179								
Other Net Allocable Income or (Loss)	(5,724,449)								
Net Allocable Income/(Loss)	$462,085,730								
* Percent Of Administrative Department Expense	72.1478%	(.2457%)	(.2069%)	.4440%	(1.0555%)	(.7760%)	.2180%	.7646%	75.2703% From Page 4

A. 779

HUMBLE OIL & REFINING COMPANY

Schedule C - 1968
Page 3 Of 4

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Calculation Of 1968 Apportionment Factor

	12/31/67		12/31/68		
	Wisconsin	Total	Wisconsin	Total	
I. Total Net Tangible Property-Per Books	$15,718,233	$3,520,220,731	$13,668,306	$3,897,803,087	
Adjustments:					
1. Net Tangible Property-Exploration & Production And Other Situs Operations		(1,845,287,774)		(2,075,112,892)	
2. Incomplete Construction - Other Than Exploration & Production And Other Situs Operations	(259,200)	(127,472,028)	(48,759)	(153,883,785)	
3. Marine Department Net Tangible Property Applicable To Allocable Charter Income		(2,400,000)			
Totals - End Of Year	$15,459,033	$1,545,060,929	$13,619,547	$1,668,806,410	
Totals - Beginning Of Year			15,459,033	1,545,060,929	
Combined Totals			$29,078,580	$3,213,867,339	
Average			$14,53[illegible]90	$1,606,933,670	
Percent To Wisconsin			.9048%		
II. Cost Of Manufacturing			$	$2,606,792,717	
Percent To Wisconsin			.0000%		
III. Total Sales - Per Wisconsin And Federal Returns			$16,117,975	$4,708,312,108	
Adjustments:					
1. Sales - Exploration & Production And Other Situs Operations				(1,183,205,556)	
2. Interdepartmental Sales - Exploration & Production And Other Situs Operations				888,233,609	
3. Taxes On Products Sold				(719,189,607)	
4. Cash Discounts				(4,643,126)	
5. Allocable Marine Department Charter Revenue				(11,139,577)	
6. Additional Wisconsin Sales			266,785		
Totals - Adjusted Sales			$16,384,760	$3,678,367,931	
Percent To Wisconsin			.4454%		
Total Percents			1.3502%		
Average Percent			.4501%		To Page 1

A. 780

Schedule C - 1968
Page 4 Of 4

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Adjustment For Administrative Department Expenses And Federal Income Tax Deduction Assignable To Allocable Income

I.	A	Total Allocable Income	$518,759,408	
	B	Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	689,195,547	
	C	Ratio Of A To B	75.2703%	To Page 2
		Administrative Department Net Loss From Operations - Per Books	$ 4,701,140	
		Ratio (I. C Above)	75.2703%	
		Administrative Department Expenses Attributable To Allocable Income	$ 3,538,562	
II.	A	Federal Income Tax Deductible	$ 68,919,555	
	B	Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deduction)	689,195,547	
	C	Ratio Of A TO B	10.0000%	

A. 781

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Allocation And Apportionment Of Marketing Department

Schedule D--1965-1968
Page 1 Of 2

	1965	1966	1967	1968	
Federal Taxable Income Before Special Deductions	$82,724,995	$47,751,861	$59,528,129	$118,269,861	From Schedule B, Line 28
Adjustments:					
Contributions Deducted	795,427	67,709	28,266	70,312	
Municipal Interest Deducted					
Percentage Depletion Deducted					
Depreciation And Amortization Deducted	44,310,867	51,195,977	52,503,703	59,629,483	
Allowable Depreciation & Amortization	(44,850,000)	(49,371,000)	(56,894,000)	(64,458,000)	
Allowable Cost Depletion					
Bad Debts	280,801	3,564,348	4,081,881	3,901,896	
COPP-Proceeds					
COPP-Repayments					
Adjusted Net Income (Wisconsin Basis) Before FIT And Contributions	$83,262,090	$53,208,895	$59,247,979	$117,413,552	
Federal Income Tax Deductible	(1,371,410)	(4,389,468)	(5,924,798)	(11,741,355)	
Contributions Deductible	(795,427)	(67,709)	(28,266)	(70,312)	
Adjusted Net Income (Wisconsin Basis)	$81,095,253	$48,751,718	$53,294,915	$105,601,885	
Net Allocable (Income)/Loss	(916,056)	(380,262)	(731,942)	1,636,880	
Apportionable Income	$80,179,197	$48,371,456	$52,562,973	$107,238,765	
Percent To Wisconsin	.8012%	.7884%	.8026%	.7371%	From Page 2
Net Income Apportioned To Wisconsin	$ 642,396	$ 381,361	$ 421,870	$ 790,457	
Wisconsin Allocable Income/(Loss)	(100,602)	(65,280)	(26,877)	43,282	
Wisconsin Net Taxable Income	$ 541,794	$ 316,081	$ 394,993	$ 833,739	To Schedule A
Tax					
$225 On 1st $6,000	225	225	225	225	
7% On Excess	37,506	21,706	27,230	57,942	
Total Tax	$ 37,731	$ 21,931	$ 27,455	$ 58,167	To Schedule A

A. 782

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Calculation of Marketing Department's Apportionment Factor

Schedule D - 1965-1968
Page 2 Of 2

	1965		1966		1967		1968	
	Wisconsin	Total	Wisconsin	Total	Wisconsin	Total	Wisconsin	Total
I. Total Net Tangible Property-Books*								
End Of Year	$11,612,536	$ 699,670,230	$13,457,131	$ 786,725,227	$15,459,033	$ 902,084,406	$13,619,547	$ 962,686,671
Beginning Of Year	10,855,359	584,465,750	11,612,536	699,670,230	13,457,131	786,725,227	15,459,033	902,084,406
Total	$22,467,895	$1,284,135,980	$25,069,667	$1,486,395,457	$28,916,164	$1,688,809,633	$29,078,580	$1,864,771,077
Average	$11,233,948	$ 642,067,990	$12,534,834	$ 743,197,729	$14,458,082	$ 844,404,817	$14,539,290	$ 932,385,539
Percent To Wisconsin	1.7497%		1.6866%		1.7122%		1.5594%	
II. Cost of Manufacturing								
Percent To Wisconsin	.0000%		.0000%		.0000%		.0000%	
III. Total Sales	$12,987,634	$2,593,111,862	$14,050,904	$2,738,881,263	$16,281,720	$3,030,095,828	$16,117,975	$3,235,048,467
Adjustments:								
1. Taxes On Products Sold		(604,758,372)		(619,212,967)		(675,340,326)		(717,549,435)
2. Cash Discounts		(3,313,216)		(3,857,618)		(4,284,102)		(4,643,126)
3. Additional Wisconsin Sales	(7,490)		307,155		68,610		266,785	
Total Adjusted Sales	$12,980,144	$1,985,040,274	$14,358,059	$2,115,810,678	$16,350,330	$2,350,471,400	$16,384,760	$2,512,855,906
Percent To Wisconsin	.6539%		.6786%		.6956%		.6520%	
Total Percents	2.4036%		2.3652%		2.4078%		2.2114%	
Average Percent	.8012%		.7884%		.8026%		.7371%	

*Excluding Incomplete Construction

A. 783

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Allocation And Apportionment Of Marketing And Refining Departments

Schedule E--1965-1968
Page 1 Of 2

	1965	1966	1967	1968	
Federal Taxable Income Before Special Deductions	$ 94,881,229	$119,328,331	$150,089,779	$177,830,121	From Schedule B, Line 28
Adjustments:					
Contributions Deducted	833,038	83,790	30,115	62,636	
Municipal Interest Deducted	136	135	135	135	
Percentage Depletion Deducted					
Depreciation And Amortization Deducted	96,342,418	94,540,878	85,886,707	109,669,440	
Allowable Depreciation And Amortization	(102,120,000)	(97,697,000)	(118,660,000)	(134,401,000)	
Allowable Cost Depletion					
Bad Debts	280,801	3,564,348	4,081,881	3,901,896	
COPP-Proceeds					
COPP-Repayments					
Adjusted Net Income (Wisconsin Basis)-Before FIT And Contributions	$ 90,217,622	$119,820,482	$121,428,617	$157,063,228	
Federal Income Tax Deductible	(1,485,975)	(9,884,591)	(12,142,862)	(15,706,322)	
Contributions Deductible	(833,038)	(83,790)	(30,115)	(62,636)	
Adjusted Net Income (Wisconsin Basis)	$ 87,898,609	$109,852,101	$109,255,640	$141,294,270	
Net Allocable (Income)/Loss	1,709,411	652,505	654,795	2,911,744	
Apportionable Income	$ 89,608,020	$110,504,606	$109,910,435	$144,206,014	
Percent To Wisconsin	.4274%	.4490%	.4705%	.4248%	From Page 2
Net Income Apportioned To Wisconsin	$ 382,985	$ 496,166	$ 517,129	$ 612,587	
Wisconsin Allocable Income/(Loss)	(100,602)	(65,280)	(26,877)	43,282	
Wisconsin Net Taxable Income	$ 282,383	$ 430,886	$ 490,252	$ 655,869	To Schedule A
Tax					
$225 On 1st $6,000	225	225	225	225	
7% On Excess	19,347	29,742	33,898	45,491	
Total Tax	$ 19,572	$ 29,967	$ 34,123	$ 45,716	To Schedule A

EXHIBIT 61 IN EVIDENCE

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Calculation of Marketing and Refining Departments' Apportionment Factor

Schedule E--1965-1968
Page 2 Of 2

	1965		1966		1967		1968	
	Marketing		Marketing		Marketing		Marketing	
	Wisconsin	Total	Wisconsin	Total	Wisconsin	Total	Wisconsin	Total
I. Total Net Tangible Property*								
End Of Year	$11,612,536	$ 699,670,230	$13,457,131	$ 786,725,227	$15,459,033	$ 902,084,406	$13,619,547	$ 962,686,671
Beginning Of Year	10,855,359	584,465,750	11,612,536	699,670,230	13,457,131	786,725,227	15,459,033	902,084,406
Total	$22,467,895	$1,284,135,980	$25,069,667	$1,486,395,457	$28,916,164	$1,688,809,633	$29,078,580	$1,864,771,077
Average	$11,233,948	$ 642,067,990	$12,534,834	$ 743,197,729	$14,458,082	$ 844,404,817	$14,539,290	$ 932,385,539
	Refining		Refining		Refining		Refining	
Total Net Tangible Property*								
End Of Year	$	$ 471,708,346	$	$ 463,506,391	$	$ 500,006,390	$	$ 634,700,208
Beginning Of Year		514,242,140		471,708,346		463,506,391		500,006,390
Total	$	$ 985,950,486	$	$ 935,214,737	$	$ 963,512,781	$	$1,134,706,598
Average	$	$ 492,975,243	$	$ 467,607,369	$	$ 481,756,391	$	$ 567,353,299
Combined Average	$11,233,948	$1,135,043,233	$12,534,834	$1,210,805,098	$14,458,082	$1,326,161,208	$14,539,290	$1,499,738,838
Percent To Wisconsin	.9897%		1.0352%		1.0902%		.9695%	
II. Cost Of Manufacturing	$	$2,273,000,657	$	$2,260,452,811	$	$2,481,078,874	$	$2,606,792,717
Percent To Wisconsin	.0000%		.0000%		.0000%		.0000%	
	Marketing		Marketing		Marketing		Marketing	
III. Total Sales	$12,987,634	$2,593,111,862	$14,050,904	$2,738,881,263	$16,281,720	$3,030,095,828	$16,117,975	$3,235,048,467
Adjustments								
1. Taxes On Products Sold		(604,758,372)		(619,212,967)		(675,340,326)		(717,549,435)
2. Cash Discounts		(3,313,216)		(3,857,618)		(4,284,102)		(4,643,126)
3. Additional Wisconsin Sales	(7,490)		307,155		68,610		266,785	
Total Adjusted Sales	$12,980,144	$1,985,040,274	$14,358,059	$2,115,610,678	$16,350,330	$2,350,471,400	$16,384,760	$2,512,855,906
	Refining		Refining		Refining		Refining	
Total Sales	$	$2,452,668,330	$	$2,492,823,766	$	$2,740,032,660	$	$2,863,537,827
Adjustments:								
1. Taxes On Products Sold		(12,997)		(2,044,801)		(2,116,887)		(1,640,172)
Total Adjusted Sales	$	$2,452,655,333	$	$2,490,778,965	$	$2,737,915,773	$	$2,861,897,655
Total Combined Marketing And Refining Sales	$12,980,144	$4,437,695,607	$14,358,059	$4,606,589,643	$16,350,330	$5,088,387,173	$16,384,760	$5,374,753,561
Percent To Wisconsin	.2925%		.3117%		.3213%		.3048%	
Total Percents	1.2822%		1.3469%		1.4115%		1.2743%	
Average Percent	.4274%		.4490%		.4705%		.4248%	

* Excluding Incomplete Construction

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Summary Of 1965 - 1968 Average Of Comparison Of Wisconsin Statutory Factor Attributes To Adjusted Net Income On Wisconsin Basis

Percent Of Factor Attributes	Exploration & Production	Marketing	Refining	Other	Total
1965	22.4%	20.6%	51.6%	5.4%	100.0%
1966	22.8%	22.1%	51.3%	3.8%	100.0%
1967	22.7%	23.2%	51.8%	2.3%	100.0%
1968	22.6%	23.3%	52.2%	1.9%	100.0%
Total	90.5%	89.2%	206.9%	13.4%	400.0%
Average	22.6%	22.3%	51.7%	3.4%	100.0%
Percent Of Income					
1965	70.5%	20.1%	1.7%	7.7%	100.0%
1966	73.0%	10.3%	12.9%	3.8%	100.0%
1967	77.9%	9.8%	10.3%	2.0%	100.0%
1968	76.1%	17.0%	5.8%	1.1%	100.0%
Total	297.5%	57.2%	30.7%	14.6%	400.0%
Average	74.4%	14.3%	7.7%	3.6%	100.0%

Summary	Percent Of Factor Attributes	Percent Of Income
Exploration & Production	22.6%	74.4%
Marketing	22.3%	14.3%
Refining	51.7%	7.7%
Other	3.4%	3.6%
Total	100.0%	100.0%

EXHIBIT 30

A. 786

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HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
Comparison of Wisconsin Factor Attributes to Adjusted Net Income on Wisconsin Basis

1965	Exploration & Production	Marketing	Refining	Marine	Enjoy	Administrative	Total
	Functional Operating Departments						
Gross Receipts - Before Eliminations	$ 882,627,759	$2,593,111,862	$2,452,668,330	$106,636,099	$310,002,695	$ -0-	$6,345,046,745
Percent of Total	13.9105%	40.8683%	38.6549%	1.6806%	4.8857%	-0-	100.0000%
Cost of Manufacturing	$ -0-	$ -0-	$2,273,000,657	$ -0-	$ -0-	$ -0-	$2,273,000,657
Percent of Total	-0-	-0-	100.0000%	-0-	-0-	-0-	100.0000%
Average Net Tangible Property	$1,693,209,257	$ 671,254,303	$ 511,562,129	$106,759,423	$135,922,141	$ 61,062,639	$3,179,769,892
Percent of Total	53.2494%	21.1102%	16.0880%	3.3575%	4.2746%	1.9203%	100.0000%
Total Percents	67.1599%	61.9785%	154.7429%	5.0381%	9.1603%	1.9203%	300.0000%
Average Percents	22.3866%	20.6595%	51.5810%	1.6794%	3.0534%	.6401%	100.0000%
Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deductions)	$ 291,988,939	$ 83,262,090	$ 6,955,532	$ 7,992,278	$ 15,961,879	$ 7,738,278	$ 413,898,996*
Percent of Total	70.5459%	20.1165%	1.6805%	1.9310%	3.8565%	1.8696%	100.0000%

*From Schedule C, Page 1 and Exhibit C of Audit Report

Summary	Percent of Factor Attributes	Percent of Income
Exploration & Production	22.4%	70.5%
Marketing	20.6%	20.1%
Refining	51.6%	1.7%
Other	5.4%	7.7%
Total	100.0%	100.0%

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A. 787

HUMBLE OIL & REFINING COMPANY

1965-1968 Wisconsin Corporation Franchise Tax Audit
Comparison of Wisconsin Factor Attributes to
Adjusted Net Income on Wisconsin Basis

1966	Functional Operating Departments: Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Enjoy	Administrative	Total
Gross Receipts - Before Eliminations	$ 976,831,436	$2,738,881,263	$2,492,823,766	$108,687,446	$ -0-	$ -0-	$ -0-	$144,517,244	$ -0-	$6,459,741,157
Percent of Total	15.0909%	42.3992%	38.5902%	1.6825%	-0-	-0-	-0-	2.2372%	-0-	100.0000%
Cost of Manufacturing	$ -0-	$ -0-	$2,260,452,811	$ -0-	$ -0-	$ -0-	$ -0-	$ -0-	$ -0-	$2,260,452,811
Percent of Total	-0-	-0-	100.0000%	-0-	-0-	-0-	-0-	-0-	-0-	100.0000%
Average Net Tangible Property	$1,725,488,494	$ 777,859,865	$ 497,918,135	$103,162,526	$ -0-	$ 6,054	$ -0-	$ 70,163,732	$70,067,803	$3,244,666,609
Percent of Total	53.1792%	23.9735%	15.3457%	3.1795%	-0-	.0002%	-0-	2.1624%	2.1595%	100.0000%
Total Percents	68.2701%	66.3727%	153.9359%	4.8620%	-0-	.0002%	-0-	4.3996%	2.1595%	300.0000%
Average Percents	22.7567%	22.1242%	51.3120%	1.6207%	-0-	.0001%	-0-	1.4665%	.7198%	100.0000%
Adjusted Net Income - Wisconsin Basis (Before FIT & Contributions Deductions)	$ 377,236,318	$ 53,208,095	$ 66,611,587	$ 9,955,812	($3,826,329)	($204,000)	$298,257	$ 5,610,178	$ 7,974,010	$ 516,864,726*
Percent of Total	72.9855%	10.2946%	12.8876%	1.9262%	(.7403%)	(.0395%)	.0577%	1.0854%	1.5428%	100.0000%

* From Schedule C, Page 1 and Exhibit C of Audit Report

Summary	Percent of Factor Attributes	Percent of Income
Exploration & Production	22.8%	73.0%
Marketing	22.1%	10.3%
Refining	51.3%	12.9%
Other	3.8%	3.8%
Total	100.0%	100.0%

A. 788

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Comparison Of Wisconsin Factor Attributes To Adjusted Net Income On Wisconsin Basis

1967	Functional Operating Departments: Exploration & Production	Marketing	Refining	Marine	Coal & Shale Oil	Minerals	Land Management	Administrative	Total
Gross Receipts-Before Eliminations	$1,093, 83,532	$3,030,095,828	$2,740,032,660	$111,538,886	$	$	$ 193,258	$	$6,975,644,164
Percent Of Total	15.6800%	43.4382%	39.2800%	1.5990%			.0028%		100.0000%
Cost Of Manufacturing	$	$	$2,481,078,674	$	$	$	$	$	$2,481,078,674
Percent Of Total			100.0000%						100.0000%
Average Net Tangible Property	$1,775,994,213	$ 882,344,435	$ 541,565,907	$ 99,379,137	$8,693,150	$ 341,317	$9,817,830	$ 63,789,853	$3,381,925,842
Percent Of Total	52.5143%	26.0900%	16.0135%	2.9385%	.2571%	.0101%	.2903%	1.8862%	100.0000%
Total Percents	68.1943%	69.5282%	155.2935%	4.5375%	.2571%	.0101%	.2931%	1.8862%	300.0000%
Average Percents	22.7314%	23.1761%	51.7645%	1.5125%	.0857%	.0034%	.0977%	.6287%	100.0000%
Adjusted Net Income-Wisconsin Basis (Before FIT & Contributions Deductions)	$ 471,833,685	$ 59,247,979	$ 62,180,638	$ 11,768,688	($7,592,065)	($2,735,293)	$ 150,151	$ 10,504,505	$ 605,358,288*
Percent Of Total	77.9429%	9.7873%	10.2717%	1.9441%	(1.2541%)	(.4519%)	.0248%	1.7352%	100.0000%

From Schedule C, Page 1 And Exhibit C Of Audit Report

Summary	Percent Of Factor Attributes	Percent Of Income
Exploration & Production	22.7%	77.9%
Marketing	23.2%	9.8%
Refining	51.8%	10.3%
Other	2.3%	2.0%
Total	100.0%	100.0%

A. 789

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HUMBLE OIL & REFINING COMPANY

1963 - 1968 Wisconsin Corporation Franchise Tax Audit
Comparison Of Wisconsin Factor Attributes To Adjusted Net Income On Wisconsin Basis

1968	Functional Operating Departments						Total
	Exploration & Production	Marketing	Refining	Coal & Shale Oil	Minerals	Land Management	Administrative	
Gross Receipts-Before Eliminations	$1,182,864,191	$3,235,048,467	$2,863,537,827	$117,586,029	$	$ 341,365	$	$7,399,377,879
Percent Of Total	15.9860%	43.7206%	38.6991%	1.5891%		.0046%		100.0000%
Cost Of Manufacturing	$	$	$2,606,792,717	$	$	$	$	$2,606,792,717
Percent Of Total			$ 100.0000%					100.0000%
Average Net Tangible Property	$1,917,335,807	$ 971,297,234	$ 659,328,042	$ 66,530,762	$18,061,961	$1,204,204	$23,398,361	$51,655,538	$3,709,011,909
Percent Of Total	51.6994%	26.1875%	17.7764%	1.7933%	.4870%	.0325%	.6308%	1.3927%	100.0000%
Total Percents	67.6854%	69.9081%	156.4761%	3.3828%	.4870%	.0325%	.6354%	1.3927%	300.0000%
Average Percents	22.5618%	23.3027%	52.1587%	1.1276%	.1623%	.0108%	.2118%	.4643%	100.0000%
Adjusted Net Income-Wisconsin Basis (Before FIT & Contributions Deductions)	$ 524,807,072	$ 117,413,552	$ 39,649,676	$ 8,737,368	($ 7,274,679)	($3,347,999)	$ 1,502,452	$ 9,707,905	$ 689,195,547
Percent Of Total	76.1478%	17.0363%	5.7530%	1.2678%	(1.0555%)	(.7760%)	.2180%	1.4086%	100.0000%

From Schedule C, Page 1 And Exhibit C Of Audit Report

Summary	Percent Of Factor Attributes	Percent Of Income
Exploration & Production	22.6%	76.1%
Marketing	23.3%	17.0%
Refining	52.2%	5.8%
Other	1.9%	1.1%
Total	100.0%	100.0%

EXHIBIT 31

SUMMARY OF WISCONSIN "HYBRID" APPORTIONMENT

#313565

3565-3572

I. Crude Oil Formula (Crude & Condensate)

1. Crude Oil Production (Net Working Interest)

A. Total Barrels Produced

Less: Barrels Sold at the Lease

B. Humble's Production Transferred to Supply

C. Ratio of Crude Oil Transferred to Produced (I.1.B ÷ I.1.A)

2. Crude Oil Refined

Humble's Production Transferred to Supply

Plus: Barrels Purchased by Supply Department

D. Barrels Available

Less: Barrels Sold by Supply Department

E. Barrels Transferred to Refineries

F. Ratio of Crude Refined to Available (I.2.E ÷ I.2.D)

G. Percent of Crude Oil Produced that Was Refined (I.1.C x I.2.F)

H. Percent of Crude Oil Produced that was not Refined (100 - I.2.G)

II. E & P Non-Apportionable Crude Oil and Natural Gas Net Income

1. E & P Department Net Sales

A. E & P Net Sales - Per FITR, Line 1

Plus: COPP Repayments

Less: COPP Sales

Non-Apportionable Gross Mineral Royalties

B. E & P Department Net Sales - Wisconsin Basis

2. E & P Department Net Income

A. Net Income - Per Federal Return (Line 28 - FITR)

Plus: COPP Repayments

Contributions

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Deductions Not Allowed By Wisconsin:

Percentage Depletion

Non-Apportionable Losses:

Situs of Property - Losses on Dispositions of Tangible Assets

Less: COPP Sales

Preservation of Basis Depreciation in Excess of Federal Non-Apportionable Income:

(1) Situs of Property:

Gains on Dispositions of Tangible Assets

Mineral Royalty Income

(2) Commercial Domicile:

Dividends & Interest Income, Less Interest Expense

B. E & P Department Net Income - Wisconsin Basis (Before Contribution & FIT Deductions)

3. Ratio of E & P Net Income To Net Sales (II.2.B ÷ II.1.B)

4. Non-Apportionable Crude Oil & Natural Gas Net Income

A. Crude Oil Net Income

(1) Total E & P Department Crude Oil Sales (Per Compcode 211)

(2) Percent Non-Apportionable (I.2.H.above)

(3) Non-Apportionable Crude Oil Sales [II.4.A.(1) x II.4.A.(2)]

(4) Ratio of E & P Net Income to Net Sales (II.3. above)

(5) Non-Apportionable Crude Oil Net Income [II.4.A.(3) x II.4.A(4)]

B. Natural Gas Net Income

(1) Total Lease & Gas System Gas Sales (Exhibit B-2 Supplement)

(2) Ratio of E & P Net Income to Net Sales (II.3.above)

(3) Non-Apportionable Natural Gas Net Income [II.4.B(1) x II.4.B.(2)]

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III. Non-Apportionable Income - Everywhere

1. Income Which Follows Situs of Property

A. Gains/Losses on Dispositions of Tangible Assets - (FITR)

B. Casualty Losses - (FITR)

C. Retirement Losses - Tangible Assets - (FITR)

D. Material Disposal Losses - (FITR)

E. Gains/Losses On Sales of Stock Materials - (FITR)

F. Land Sales - (FITR)

G. Net Mineral Royalty Income - (General Factor File)

H. Crude Oil Net Income - [II.4.A.(5)]

I. Natural Gas Net Income - [II.4.B.(3)]

J. Marine Charter Net Income - (Gross Charter Hire Revenue Per Compcode 211, Less the Book Historical Cost Per Day of Operation Times the Number of Days and Types of Vessels Under Charter During the Year)

2. Income Which Follows Commercial Domicile

A. Dividend & Interest Income, Less Interest Expense - (FITR)

B. Non-Mineral Royalty Income - (FITR)

3. Total Non-Apportionable Income (III.1 + III.2)

Less: Allocation of Administrative Department Expenses (Ratio of III.3 to X.2 x Administrative Department Unallocated Book Expenses)

Federal Income Tax (Ratio of III.3 to X.2 x Federal Income Tax Billed to Humble by SONJ and Paid During Taxable Year)

4. Net Non-Apportionable Income - Everywhere

IV. Non-Apportionable Income - Wisconsin

1. Income Which Follows Situs of Property

A. Gains/Losses on Dispositions of Tangible Assets - (State Disposal Report)

B. Casualty Losses - (State Disposal Report)

2. Income Which Follows Commercial Domicile - None 3568

3. Total Wisconsin Non-Apportionable Income (IV.1 + IV.2)

Less: Federal Income Tax (Ratio of IV.3 to x Federal Income Tax Billed to Humble By SONJ and Paid During Taxable Year)

4. Net Wisconsin Non-Apportionable Income

V. Sales Factor

1. Numerator - Wisconsin Sales (Per State Sales Report)

2. Denominator:

A. Net Sales (Per Line 1 - FITR)

Plus: COPP Repayments (FITR)

Less: COPP Sales (FITR)

Gross Mineral Royalty Income (General Factor File)

Consumer Taxes (FITR)

Sales Discounts (FITR)

Non-Apportionable Crude Oil Sales [II.4.A.(3)]

Non-Apportionable Natural Gas Sales [II.4.B.(1)]

Non-Apportionable Marine Charter Revenue (III.1.J)

B. Net Apportionable Sales - Wisconsin Basis

3. Sales Factor (Ratio V.1 to V.2.B)

VI. Cost of Manufacturing Factor (Zero - No Within Wisconsin Costs)

VII. Cost of Manufacturing Factor - Weight

1. Net Apportionable Sales - Wisconsin Basis (V.2.B)

Less: Sales of Purchased Products:

Refined Products (Special Calculation)

Tires, Batteries & Accessories (Per Compcodes)

Crude Oil (Crude Oil & Condensate Sales of the Refining Department to Outsiders - Per Compcode 211, Less Non-Apportionable Crude Oil Sales - II.4.A.3)

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2. Net Sales of Humble's Manufactured Products

3. Cost of Manufacturing Weight (VII.2 ÷ VII.1)

VIII. Property Factor

1. Calculation of E & P Department Non-Apportionable Percentage

A. Non-Apportionable Natural Gas Net Income [II.4.B.(3)]

B. E & P Department Net Income - Wisconsin Basis (II.2.B)

C. Percent of Non-Apportionable Natural Gas Net Income To E & P Department Net Income - Wisconsin Basis (VIII.1.A ÷ VIII.1.B)

D. Reciprocal of VIII.1.C (Which Represents The Balance of E & P Department Net Income - Wisconsin Basis, Part of Which is Non-Apportionable)

E. Percent of Crude Oil Produced That Was Not Refined (I.2.H)

F. Non-Apportionable Portion of VIII.1.D (VIII.1.D x VIII.1.E)

G. E & P Department Non-Apportionable Percentage (VIII.1.C + VIII.1.F)

2. Average Net Non-Apportionable Tangible Property - Everywhere

A. E & P Department Non-Apportionable Tangible Property

(1) Net Property, Plant & Equipment (Assets by State Report)

Plus: Materials & Supplies (Assets by State Report)

Inventories (Assets by State Report)

Less: Incomplete Construction (Assets by State Report)

Lease & Well - Intangibles (Assets by State Report)

Investment in Mineral Royalties (LC 504, 513, & 613)

Net Value of Gas Plants (E & P Department's Table 18)

(2) Adjusted E & P Tangible Property - Wisconsin Basis

(3) E & P Department Non-Apportionable Percentage (VIII.1.G)

(4) E & P Department Non-Apportionable Tangible Property, Other Than Investment in Mineral Royalties [VIII.2.A.(2) x VIII.2.A.(

3570

(5) Add: Investment in Mineral Royalties

(6) Total E & P Department Non-Apportionable Tangible Property /VIII.2.A.(4) + VIII.2.A.(5)/

B. Marine Department Non-Apportionable Tangible Property - Average Net Investment In Vessels Under Charter

C. Average Net Non-Apportionable Tangible Property - Everywhere /VIII.2.A.(6) + VIII.2.B./

3. Calculation of Property Factor (Average Net Tangible Property)

A. Numerator:

(1) Net Wisconsin Property, Plant & Equipment (Assets By State Report)

Plus: Materials & Supplies (Assets by State Report)

Inventories (Assets by State Report)

Less: Incomplete Construction (Assets by State Report)

(2) Average Net Wisconsin Tangible Property - Wisconsin Basis

B. Denominator:

(1) Net Property, Plant & Equipment - Everywhere (Assets by State Report

Plus: Materials & Supplies (Assets by State Report)

Inventories (Assets by State Report)

Less: Incomplete Construction (Assets by State Report)

Lease & Well - Intangibles (Assets by State Report)

Average Net Non-Apportionable Tangible Property - Everywhere (VIII.2.C.)

(2) Average Net Everywhere Tangible Property - Wisconsin Basis (Property Producing Apportionable Income)

C. Property Factor /Ratio VIII.3.A.(2) to VIII.3.B.(2)/

IX. Apportionment Factor

1. Factors

A. Sales Factor (V.3)

B. Cost of Manufacturing (VI) (Which is Zero)

C. Property Factor (VIII.3.C)

D. Total Factors (IX.1.A, + IX.1.B. + IX.1.C.)

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2. Weight of Factors

A. Sales Factor (1)

B. Cost of Manufacturing (VII.3 - Less than 1)

C. Property Factor (1)

D. Total Weight of Factors (IX.2.A. + IX.2.B. + IX.2.C.)

3. Apportionment Factor (IX.1.D ÷ IX.2.D)

X. Calculation of Wisconsin Taxable Income

1. Federal Taxable Income Before Special Deductions (Line 28 - FITR)

Plus: Contributions Deducted (FITR)

Interest Income - State & Local Obligations (FITR)

Percentage Depletion (FITR)

Federal Depreciation (FITR)

Excess Bad Debts Provision (Reserve Provision vs. Charge-Offs)

COPP Repayments (FITR)

Less: COPP Sales (FITR)

Preservation Of Basis Depreciation (Depreciation & Depletion Section)

Cost Depletion /Book, Plus Amortization of A/C 902 (Other Lease Costs)/

2. Adjusted Net Income on Wisconsin Basis (Before Contributions & FIT Deductions

Less: Contributions During Current Year (No Carryover Provisions)

Federal Income Tax (Limited to 10% of X.2)(Federal Income Tax Billed to Humble by SONJ and Paid During Taxable Year, Regardless of Year to Which Tax is Applicable)

3. Adjusted Net Income on Wisconsin Basis (After Contributions & FIT Deductions)

Less: Net Non-Apportionable Income - Everywhere (III.4)

4. Apportionable Net Income on Wisconsin Basis

5. Apportionment Factor (IX.3)

6. Income Apportioned to Wisconsin (X.4 x X.5)
   Add: Net Wisconsin Non-Apportionable Income
7. Wisconsin Taxable Income

EXHIBIT 35

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Comparison Of Net Income Of Total Company With Assessed Income From Wisconsin Operations

Year	(1) Wisconsin Sales	(2) Wisconsin Assessed Taxable Income	Net Income Percentage Of Sales	(3) Total Company Sales	(4) Total Company Net Income Wisconsin Basis	Net Income Percentage Of Sales
1965	$12,980,144	$ 759,371	5.9%	$3,462,675,348	$403,594,652	11.6%
1966	14,358,059	1,043,395	7.3%	3,480,707,694	468,647,833	13.5%
1967	16,350,330	1,264,946	7.7%	3,720,832,181	541,954,615	14.6%
1968	16,384,760	1,464,443	8.9%	3,984,479,455	608,009,771	15.3%
Totals	$60,073,293	$4,532,155	7.5%	$14,648,694,678	$2,022,206,871	13.8%

Notes:
1) From State Audit, Page 12 (Exhibit E-3) EXHIBIT # _____
2) From State Audit, Page 1 (Exhibit A-B) EXHIBIT # _____
3) See Computation Below
4) From State Audit, Page 2 (Exhibit C) EXHIBIT # _____

*3	1965	1966	1967	1968
Total Company Sales	$4,070,986,858	$4,095,866,931	$4,402,573,496	$4,708,312,188
Adjustments				
1. Taxes on Products Sold	(604,793,382)	(611,275,049)	(677,457,213)	(719,189,607)
2. Cash Discounts	(3,518,128)	(3,884,188)	(4,284,102)	(4,643,126)
Total Adjusted Sales	$3,462,675,348	$3,480,707,694	$3,720,832,181	$3,984,479,455

* From State Audit, Page 12 (Exhibit E-3) EXHIBIT # _____

Supreme Court, U.S.
FILED
OCT 24 1979
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-509

EXXON CORPORATION,
Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the
Supreme Court of Wisconsin

MOTION TO DISMISS OR AFFIRM

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MOTION TO DISMISS OR AFFIRM

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EXXON CORPORATION,
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WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the
Supreme Court of Wisconsin

MOTION TO DISMISS OR AFFIRM

The appellee moves the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of Wisconsin on the ground that the questions presented by the appellant are so unsubstantial as not to need further argument.

OPINIONS BELOW

The opinion of the Supreme Court of Wisconsin is reported at 90 Wis. 2d 700, 281 N.W. 2d 94 (1979); the opinion of the Dane County Circuit Court is reported at CCH Wis. Tax Reports, par. 201-373; and the

Decision, Findings of Fact and Conclusions of Law of the Wisconsin Tax Appeals Commission is reported at CCH Wis. Tax Reports, par. 201-223.

JURISDICTION

The jurisdictional requisites are set forth in appellant's Jurisdictional Statement.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Commerce Clause (Art. I, §8, cl. 3): "The Congress shall have power ... to regulate commerce with foreign Nations and among the several States, and with the Indian Tribes."

Due Process Clause (Amend. XIV, §1): "[N]or shall any State deprive any person of life, liberty, or property, without due process of law."

Wis. Stats. (1967) §71.07 (1) and (2):

> **Situs of income; allocation and apportionment.** (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived. Corporation income from personal services performed by employes of corporations shall be deemed business income and shall follow the situs of the business. Income from personal services and from professions of

> resident individuals shall follow residence. Income from personal services of nonresident individuals, including income from professions, shall follow the situs of the services. All other income or loss, including royalties from patents; income or loss derived from land contracts, mortgages, stocks, bonds and securities or from the sale of similar intangible personal property, shall follow the residence of the recipient, except as provided in s. 71.07 (7). For the purposes of taxation, interest received on state and federal tax refunds when the tax refunded was on business income or property shall be deemed income from business and shall follow the situs of the business from which derived.
>
> (2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such party thereof (less related expenses, if any) as follows the situs of the property or the

residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:

QUESTIONS PRESENTED

1. Whether the State of Wisconsin's treatment of Appellant as a unitary business has rendered Wis. Stats. s. 71.07 (2) invalid under the Due Process Clause of the fourteenth amendment to the United States Constitution.

2. Whether the State of Wisconsin's formula for taxing unitary businesses results in an unconstitutional tax on a portion of Appellant's income derived from outside the State so as to constitute a construction of Wis. Stats. ss. 71.07 (1) and (2) which renders the statute invalid under the Due Process Clause of the fourteenth amendment to the United States Constitution.

3. Whether the State of Wisconsin's formula for taxing unitary businesses results in an unconstitutional tax on a portion of Appellant's income derived from outside the state so as to constitute a construction of Wis. Stats. ss. 71.07 (1) and (2) which renders the statute invalid under the Commerce Clause of the United States Constitution.

STATEMENT OF THE CASE

This case was commenced by the appellant when it appealed Appellee's denial of its application for abatement of an additional franchise tax assessment for the years 1965 through 1968. The appeal was taken to the Wisconsin Tax Appeals Commission wherein Appellant contended that Appellee's method of taxing Appellant's net income was in violation of both the fourteenth amendment to the United States Constitution, and the Commerce Clause of the United States Constitution. The Tax Appeals Commission found that:

1. Appellant's three main functional operations were each separate unitary businesses;

2. Appellee's apportionment formula improperly included income from sources outside Wisconsin;

3. An apportionment formula apportioning only income earned by Appellant from its marketing function would be proper; and

4. Appellee's assessment subjected part of Appellant's income to multiple taxation.

The Appellee appealed the Commission's decision to the Circuit Court for Dane County, Wisconsin. By order entered on January 31, 1977, that court found that Appellant was a unitary business and that its total income was subject to apportionment by Wisconsin. That court also found that all of Appellant's income from exploration and production should be excluded from apportionment as situs income and that some of Appellant's exploration and production income was being subjected to double taxation.

The circuit court decision was appealed to the Wisconsin Supreme Court on cross-appeals. Appellant appealed the unitary business issue and Appellee

appealed the situs income issue. The Wisconsin Supreme Court affirmed the circuit court's decision on the unitary business issue, and reversed the circuit court's decision on the situs income issue.

Appellant has filed an appeal with this Court to obtain review of the judgment of the Wisconsin Supreme Court. The appellant raises three questions on appeal which are set forth above. It is the position of the Appellee that none of appellant's questions raise a substantial federal question not previously determined by this Court. The Appellee's argument in support of this position follows.

ARGUMENT

I. The Case Presents No Substantial Due Process Question Not Previously Decided By This Court.

A. Wisconsin may properly treat appellant's business as a unitary business.

This Court has long recognized the concept of the unitary business. *Butler Bros. v. McColgan,* 315 U.S. 501 (1942). In concluding that California could properly treat a wholesale dry goods and general merchandise business as a unitary business, the Court stated:

> At least since Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, 17 S.Ct. 305, 41 L.Ed. 683, this Court has recognized that unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis. As stated in Hans Rees' Sons, Inc., v. North Carolina, supra, 283 U.S. page 133, 51 S.Ct. page 389, 75 L.Ed. 879,[fn] "*** the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits."

315 U.S. at 508.

The term unitary business has been variously defined. The definition relied on by the Wisconsin Supreme Court, as borrowed from the text authority of Altman & Keesling, *Allocation of Income In State Taxation,* (2d ed.), p. 101, is whether " 'the operation of the portion of the business within the state is dependent upon or contributory to the operation of the

business outside the state.'" 90 Wis. 2d at 711, 281 N.W. 2d at 100. The test relied on by this Court in *Butler Bros.* is whether there exists a unity of ownership and management. 315 U.S. at 508.

Using either approach, the holding of the Wisconsin Supreme Court, that Appellant was a single unitary business, is amply supported by the record. The Wisconsin Supreme Court properly determined that the issue of whether Appellant's operations constituted a unitary business presented a question of law. In arriving at its determination that Appellant's business was unitary the Wisconsin court considered and relied on a series of undisputed factual determinations. 90 Wis. 2d at 714-18, 281 N.W. 2d at 102-04.

The court pointed out that while Appellant's corporate organization consisted of three parts referred to as corporate management, coordination and service management, and operations management, the court was concerned only with operations management, which was the part responsible for directing the operating activities of the individual functional segments of the company.

The three major individual functional segments, or departments, of operations management were Exploration and Production, Refining, and Marketing. Each of these departments had its own management responsible for conducting the operation of the department and a separate profit center where expense and revenue were recorded to determine a profit for that department. The company considered each department a separate investment center.

Company policy required the transfer of products and raw materials between departments to be based upon competitive wholesale market prices. Interdepartmental transfers were accounted for either at

posted industry prices, or at prices determined through "arm's length" negotiations between representatives from the various departments. These prices were recorded in order to determine the performance of each department.

Appellant manufactured and produced motor oils, greases, and other packaged products outside of Wisconsin, and shipped them into the state for sale. It purchased tires, batteries, and accessories through its central purchasing office, and shipped them into Wisconsin for sale. It also transported into Wisconsin gasoline and fuel oil obtained through an exchange agreement with another oil company in order to reduce the cost of transporting gasoline and fuel oil from the source of production to the point of sale.

The Wisconsin Supreme Court pointed out that Appellant has a centrally administered credit card system used nationwide; that it promotes its products by uniform packaging and brand names; that it uses centrally designed promotional display equipment; and that its overall distribution plan is developed at its central office. It also pointed out that key employes are frequently transferred from one department to another.

The court, while indicating that Appellant had no production or refining functions in Wisconsin, stated:

> What emerges from this pattern of organization is that Humble's production and refining functions depended upon the marketing operation to provide an outlet for its products. Wisconsin was a part of Humble's marketing system. In a high capital investment industry such as the petroleum industry, the existence of a stable and assured marketing system is important for the full utilization of refining capacity. This was the

> testimony of a top Exxon executive who admitted that the profits of the overall corporation depend on the profits of each of the individual functional segments.

90 Wis. 2d at 718, 281 N.W. 2d at 104.

The testimony the Wisconsin Supreme Court was referring to came from Oral Luper, a senior vice president of Appellant, wherein he explained why the separate corporate departments were organized under one corporate entity.

> " ... [I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> "So, in the case of the petroleum industry ... where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore when there are — when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time."

90 Wis. 2d at 716, 281 N.W. 2d at 103.

Thus, Appellant's own witness demonstrated that unity of ownership and management is directly related to the maintenance of corporate-wide profits and

thereby supplied the very basis for the wide acceptance of the concept of the unitary business.

The Oregon Tax Court, in a case involving the same corporation and nearly identical facts, held that Appellant's activities in Oregon were part of a unitary business although its Oregon operations dealt almost exclusively with marketing. That court in *Humble Oil & Refining Company v. Dept. of Revenue,* 4 OTR 284 (1971), commented:

> Humble Oil & Refining Company is a large vertically integrated corporation engaged nationwide in all phases of the petroleum industry, from discovery through production and manufacture to marketing. It has unity of ownership, operations, management, control and products; and strong centralized credit, purchasing, advertising, accounting and legal services. All segments of plaintiff's business have a great deal in common and contribute to and are dependent upon each other. The plaintiff is actually a single interrelated unitary business operation. The component parts, including those in Oregon, are too closely connected and necessary to each other to be considered as independent units.

4 OTR 292.

The finding by the Wisconsin Supreme Court that Appellant's business was unitary is consistent with the *Butler Brother's* holding. It presents no substantial due process question not previously decided by this Court.

B. *Subjecting income from Appellant's unitary business to apportionment does not violate the Due Process Clause of the fourteenth amendment to the United States Constitution.*

In *Butler Bros.* this Court said: "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 688, 56 S.Ct. 625, 628, 80 L.Ed. 977." 315 U.S. at 507.

The Appellant suggests that its analysis based on separate functional accounting establishes that Wisconsin is attempting to tax income which has no reasonable relationship to the taxing state. The State of Wisconsin submits that while its formulary apportionment approach to Appellant's business does not necessarily identify the precise geographical source of income, it is a reasonable, if not the best possible, method of apportioning income from a unitary business.

This Court in *Moorman Mfg. Co. v. Bair,* 437 U.S. 267 (1978), rejected the claim that the Constitution invalidates an apportionment formula whenever the formula might result in taxation of some income which did not have its source in the taxing state. The Court recognized the imprecision of a formulary approach but stated: "Yet despite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula." 437 U.S. at 273.

However valuable or necessary Appellant's accounting system may be as a business aid, it does not prove Appellant's claim that Wisconsin is taxing

extraterritorial income. As stated by this Court in *Butler Bros.*:

> Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore. A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 121, 41 S.Ct. 45, 47, 65 L.Ed. 165, that a State in attempting to place upon a business extending into several States "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." Furthermore, the particular system used may not reveal the facts basic to the State's determination. Bass, Ratcliff & Gretton, Ltd., v. State Tax Commission, supra, 266 U.S. page 283, 45 S.Ct. page 84, 69 L.Ed. 282. In either aspect of the matter the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here.

315 U.S. at 507-08.

The Wisconsin formula, like the California formula at issue in *Butler Bros.,* is a method of apportioning income of unitary businesses in a manner calculated to assign to Wisconsin "that portion of the net income 'reasonably attributable' to the business done there."

315 U.S. 506. Appellant's contention that the Wisconsin formula attributes to Wisconsin a percentage of income all out of appropriate proportion to business transacted by the appellant in Wisconsin is refuted by the opinion of the Wisconsin Supreme Court wherein it is pointed out that Appellant's Wisconsin sales for the four years in question represented only 41/100 of one percent of its total company sales; and the Wisconsin assessed taxable income for the four years represented only 22/100 of one percent of total company net income. 90 Wis. 2d at 729, 281 N.W. 2d at 110.

The nexus requirement of *National Bellas Hess, Inc. v. Department of Rev.,* 386 U.S. 754, (1967), that a state may not impose a tax unless there is some minimum connection between the activities of the taxpayer in the state and the taxing state is amply satisfied by the fact that for the four year period in question the Appellant had sales in Wisconsin in the amount of $60,073,293. The *National Bellas Hess* case does not support Appellant's contention that since there are no exploration and production activities by Appellant in Wisconsin, there can be no connection between such activities and the State. Such a contention, ignores the very nature of the unitary business and the reason why most states now use some method of formulary apportionment. The multistate and multinational centrally managed businesses of today are little affected by state or national boundaries.

Thus, while the Appellant's separate functional accounting system may be useful as a business aid, it is, as pointed out by the Wisconsin Supreme Court, "incompatible with the

> ' very essence of formulary apportionment, namely, that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no

> logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps. It is for that reason that the States have resorted to formulary apportionment — unrefined and approximate though the results may be — in the case of an enterprise engaged in manufacturing and selling, where the activities take place in more than one State. Essentially, the same inherent difficulties are present in seeking to divide the profits of an oil company, where producing manufacturing and marketing take place in different States. Hellerstein, *State And Local Taxation,* (3rd Edition, 1969), p. 400.' "

90 Wis. 2d at 726, 281 N.W. 2d at 109.

Subjecting Appellant's unitary business to apportionment under Wisconsin's three-factor formula presents no substantial due process question not previously decided by this Court.

II. The Case Presents No Substantial Commerce Clause Question Not Previously Decided By This Court.

Appellant's assertion that Wisconsin's apportionment formula violates the Commerce Clause of the United States Constitution because it includes income from Appellant's exploration and production operations is incompatible with the formulary apportionment approach to the taxation of income from multistate unitary businesses. The rationale behind formulary appointment is that income from a unitary business cannot be accurately or logically attributed to a particular step in the economic process. Under the unitary business approach to taxation of large multistate businesses the Wisconsin apportionment formula does not impose a tax measured by any income from Appellant's business which is not properly apportioned to Wisconsin.

The multiple or duplicative taxation claim of Appellant is without merit. As pointed out by the Wisconsin Supreme Court, there is no evidence that Appellant was taxed on more than 100% of its total net income. 90 Wis. 2d at 729, 281 N.W. 2d at 110. Wisconsin can hardly be accused of reaching beyond the limits of constitutional mandates in view of the fact that Wisconsin's assessment of taxable income for the period in question represented only 22/100 of one percent of total company income and for the same period Wisconsin sales constituted only 41/100 of one percent of total company sales.

Although in the instant case there is no evidence of duplicative taxation by Wisconsin, the Commerce Clause does not prohibit some overlap in the computation of taxable income. Thus this Court in *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, concluded that the Iowa

single-factor sales formula did not violate the Commerce Clause even though some corporate income might be doubly taxed. Although noting that the record did not demonstrate the fact of duplicative taxation, the Court said that even assuming some overlap, the Commerce Clause by itself does not prohibit overlap in the computation of taxable income by the state.

> If the Constitution were read to mandate such precision in interstate taxation, the consequences would extend far beyond this particular case. For some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income. Accepting appellant's view of the Constitution, therefore, would require extensive judicial lawmaking. Its logic is not limited to a prohibition on use of a single-factor apportionment formula. The asserted constitutional flaw in that formula is that it is different from that presently employed by a majority of States and that difference creates a risk of duplicative taxation. But a host of other division-of-income problems create precisely the same risk and would similarly rise to constitutional proportions.

437 U.S. at 278.

The *Moorman* case appears to be Appellant's sole authority to support its position with regard to its Commerce Clause argument. The holding of that case does not support Appellant's position. It does not render Wisconsin's tax invalid.

The State of Wisconsin's formulary apportionment approach to taxation of large multistate unitary

businesses recognizes the economic realities which result from the existence of such enterprises. Wisconsin has not, by taxing 22/100 of one percent of Appellant's income, extended its grasp beyond constitutional limits. Appellant cannot show that the tax discriminates against interstate commerce or that it creates an undue burden on such commerce. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).

Thus, subjecting Appellant's unitary business to apportionment under Wisconsin's three-factor formula presents no substantial Commerce Clause question not previously decided by this Court.

CONCLUSION

Wherefore, Appellee respectfully submits that the questions upon which this cause depends are so unsubstantial as not to need further argument, and Appellee respectfully moves the Court to dismiss this appeal or, in the alternative, to affirm the judgment entered in the cause by the Supreme Court of Wisconsin.

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No. 79-509

In the Supreme Court of the United States

OCTOBER TERM, 1979

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

BRIEF OF APPELLANT

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In the Supreme Court of the United States

OCTOBER TERM, 1979

NO. 79-509

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

BRIEF OF APPELLANT

OPINIONS BELOW

The opinion of the Supreme Court of Wisconsin is reported at 90 Wis.2d 700, 281 N.W.2d 94 (1979); the opinion of the Dane County Circuit Court is reported at CCH Wis. Tax Reports, par. 201-373; and the Decision and Order, Findings of Fact and Conclusions of Law of the Wisconsin Tax Appeals Commission is reported at CCH Wis. Tax Reports, par. 201-223. Copies of the foregoing are set forth, respectively, in Appendices A, B and C at JS App. 1, App. 36 and App. 66 to Appellant's Jurisdictional Statement (herein referred to as "JS App.").

JURISDICTION

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257(2), this being an appeal which questions the validity of Wis. Stats. §§71.07(1) and (2) on the ground that they are repugnant to the Constitution of the United States, the validity of which was upheld by the Supreme Court of Wisconsin.

The opinion of the Supreme Court of Wisconsin was filed on June 29, 1979. A remittitur order was entered on August 7, 1979. No rehearing was had or requested. The Notice of Appeal was filed with the Supreme Court of Wisconsin on September 21, 1979.

The Jurisdictional Statement was docketed with this Court on September 26, 1979, and this Court noted probable jurisdiction on November 26, 1979.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Commerce Clause (Art. I, §8, cl. 3):

> "The Congress shall have power . . . to regulate commerce with foreign Nations and among the several States, and with the Indian Tribes;"

Due Process Clause (Amend. XIV, §1):

> "[N]or shall any State deprive any person of life, liberty, or property, without due process of law;"

The pertinent parts of Wis. Stats. §§71.07(1) and (2) are set forth in Appendices F and G, JS App. 80.

QUESTIONS PRESENTED

1. Whether the State of Wisconsin's assertion that Appellant's total corporate operations constitute a single unitary business for purposes of state taxation, coupled with some alleged nexus between Appellant's operations within the State and some phase of Appellant's total corporate activities, thereby subjecting virtually all of Appellant's corporate income to apportionment, has rendered Wis. Stats. §71.07(2) invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

2. Whether the State of Wisconsin's assessment of income tax on Appellant's Exploration and Production functional income derived outside the State from extraction of oil and gas not sold to third parties at the well head, and thereby refusing to allocate such income to situs, constitutes a construction of Wis. Stats. §§71.07(1) and (2) which renders the statute invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

3. Whether the State of Wisconsin's assessment of income tax on Appellant's Exploration and Production functional income derived outside the State from extraction of oil and gas not sold to third parties at the well head, and thereby refusing to allocate such income to situs, constitutes a construction of Wis. Stats. §§71.07(1) and (2) which renders the statute invalid under the Commerce Clause of the United States Constitution.

STATEMENT OF THE CASE

A. Corporate Organizational History.

Exxon Corporation ("Exxon") was formerly named Standard Oil Company (New Jersey), which prior to the name change in late 1972 was the parent of a wholly owned subsidiary corporation named Humble Oil & Refining Company ("Humble"). At about the time of the name change Humble was merged into Exxon, making Exxon the legal successor to Humble, the original taxpayer in this action.

B. Reporting and Audit Pattern.

Appellant timely filed its Wisconsin corporate income and franchise tax returns for the calendar tax years of 1965 through 1968. These returns were prepared and the computations made on the separate state accounting method. Losses were sustained in all four of these calendar years, and no tax was shown as being due for any of these years. (Exhibits 11-7A, 7B, 7C and 7D; A. 636-719). On adverse examination the auditor for the Wisconsin Department of Revenue (the "Department") admitted he could not really challenge the separate accounting results. (A. 627-635).

The field audit for the years in issue concluded that Appellant "is an integrated oil company" and that since Appellant "is a unitary company and its Wisconsin business is an integral part thereof, formula apportionment of the company's income is mandatory and separate accounting is not permissible." As a result it was found that Appellant was "subject to tax on or measured by additional income of $4,532,155" for the period of 1965 through 1968. Additional taxes in the amount of $316,470.85 were thereby assessed. (Exhibit 15, A. 744-750).

The Department in its audit subjected Appellant's income to formula apportionment under the Wisconsin statutes, and in the case of crude oil production the Department devised and applied what was termed the "barrel formula" as a means (at least according to the Department's theory) of separating two sets of income figures:

(a) That derived from the well head sale to third parties of crude oil produced by Appellant; and

(b) That derived from crude oil produced by Appellant and transferred to its refineries.

The former was allocated to situs and the latter was left in the apportionment formula. (A. 73-74). This separation attempted by the Department was an impossible one, for Appellant both bought and sold crude oil, and the crude oil that went to Appellant's refineries, due to commingling, had completely lost its identity as between Appellant's produced crude and its purchased crude. (A. 299-300).

C. History Before Lower Courts.

To contest this assessment Appellant filed its Petition for Review (see Appendix H, JS App. 81) with the Wisconsin Tax Appeals Commission ("Commission"). The Commission, after extensive hearings, rendered its Decision and Order on April 8, 1976 (see Appendix C, JS App. 66), holding in pertinent part that:

1. Appellant's three main functional operations, Exploration and Production, Refining and Marketing, were each separate unitary businesses;

2. The apportionment formula used by the Department in the audit and assessment was improper in including income from Appellant's Exploration and Production and Refining functions, and resulted in a tax on extraterritorial income earned by Appellant;

3. An apportionment formula, apportioning income earned by Appellant from its Marketing function within and without the State of Wisconsin, would be proper within the mandate of Section 71.07(2); and

4. Under the Department's assessment the income of Appellant's Exploration and Production and its Refining functions was subjected to multiple taxation.

The Commission's decision was appealed by the Department to the Circuit Court for Dane County, Wisconsin. That court rendered a Memorandum Decision (see Appendix B, JS App. 36) finding that Appellant's total corporate business constituted a single unitary business and that its total corporate income was subject to apportionment. However, the Circuit Court also found that all of Appellant's income from its Exploration and Production function was situs income and could not be included in apportionable income by the Department, without regard to whether the extracted crude oil and gas was sold to third parties at the well head or transferred to Appellant's refineries. In addition, the Court found that the taxation of income from Appellant's crude oil and gas produced and not sold to third parties resulted in multiple taxation of such income.

The Circuit Court's decision was brought before the Wisconsin Supreme Court on cross appeals, with Appellant appealing the decision regarding the unitary business holding and the Department appealing the situs income question.

The Wisconsin Supreme Court reversed the Circuit Court's decision on the situs income issue and affirmed on the single, corporate unitary business issue (see Appendix A, JS App. 1).

D. Appellant's Corporate Structure and Corporate Operational Pattern.

Appellant's corporate organization structure during the years at issue consisted of three parts, Corporate Management, Coordination and Services Management, and Operations Management. Corporate Management was composed of a board of directors, an executive committee, a chairman of the board who was also the chief executive officer, a president and various directors-in-charge who were members of the board of directors. (Exhibit 20, A. 755; A. 187). Coordination and Services Management consisted of corporate staff departments with the responsibility of providing the overall specialized corporate services that were needed by the corporation. (A. 188-189).

Operations Management was responsible for directing the operating activities of the individual functional segments of Appellant which consisted of Exploration and Production, Refining, Marketing, Marine, Coal and Shale Oil, Minerals, and Land Management. Each functional segment was organized into a separate department which operated independently of each other operating segment, and was organized in a way so that it could perform essentially on a stand-alone basis. Each operating department was responsible for its own performance both operationally and financially. (A. 193-194).

The Exploration and Production functional department was actually composed of three segments, Exploration, Production and Natural Gas. Exploration had the responsibility for the acquisition of reserves of crude oil and gas. Production was responsible for the operation of all of Appellant's producing oil and gas properties including the operation of the natural gas plants and related facilities. Natural Gas was responsible for the purchase and

sale and distribution of natural gas. These three segments were considered part of the Exploration and Production function by the company for accounting purposes. (A. 194-196).

The Refining Department was responsible for the operation of Appellant's refineries and associated facilities which manufactured petroleum products, special products and petrochemical feed stocks. The Marketing Department was responsible for the distribution and sale of petroleum products through Appellant's marketing facilities. (A. 196).

Each of the functional operating departments had its own separate management responsible for the proper conduct of department operations. (A. 203-204). Each functional department was a separate investment center, and records were maintained for each of these departments to reflect the investments in properties and fixed plant. Each operating department had its own accounting office which recorded and reported the cost analysis and the financial results of its operations. (A. 204-206).

Appellant did not have any crude oil or natural gas production in the State of Wisconsin, nor did it have any refineries located in the State of Wisconsin. Only Appellant's Marketing Department operated in Wisconsin. (Exhibit 21, A. 756; A. 214 and 221).

The State of Wisconsin was an expansion marketing area where Appellant was making an entry into a new market. Appellant was not widely known in Wisconsin, had limited facilities in the State and, therefore, was required to make additional investments over a long period of time in order to achieve the market position that would make Wisconsin acceptable as a mature market. During the 1960's, results of the marketing operations in Wisconsin were very unsatisfactory and resulted only in losses. (A. 216-218).

E. Utilization of Third-Party Transfer Prices.

It was the policy of Appellant that the transfer prices or values for products and raw materials passing between its three major functional departments, *i.e.,* Exploration and Production, Refining and Marketing, should be based upon competitive wholesale market prices. As there was no mandatory requirement for crude oil produced by Appellant to flow through its own refineries, and no requirement that its refined products flowing into Marketing be produced from Appellant's own crude oil production, such crude was either sold to third parties or transferred to one of Appellant's refineries depending upon which method would be the most economical. These refineries were not interested in the ownership of the crude or in the source from which it was produced, but, rather, were concerned only with the quality and type of crude oil that was available. (A. 204-206, 299). Appellant produced crude oil was always transferred from Production to its Supply Department (a non-profit center for the purchase, sale and distribution of crude oil) and then on to the Refining Department or sold to the third parties on the basis of the posted field price for the field in which the crude was produced plus the applicable tariff for transportation. (A. 206-207 and 299-300).

A posted field price was a published price which indicated what a company was willing to pay for the crude oil it might buy from a particular field. It applied to all purchases of that particular crude, but it was not a commitment to buy; nonetheless it was a publication of the price at which crude oil would be purchased if it was in fact purchased. Supply determined what Appellant had to pay in order to buy the crude oil it needed. The posted field prices were printed on bulletins by the company which was purchasing the crude oil, and it was a bona fide competitive price. All dispositions of crude oil by Appellant

were made at the posted field price, whether the distribution was a transfer to Appellant's refineries by the Supply Department or a sale to third parties by Supply. (A. 301-304; Exhibit 11-11, pp. 1-2, A. 720-721).

The posted field price was the price utilized by Appellant to pay royalty owners under the leases that permitted Appellant to produce the oil. This price was also used by Appellant to pay for oil purchased from any parties having working interests in any particular wells or leases. Whenever Appellant sold crude oil to third parties the posted field price was used as the sales price. Supply, in turn, when it transferred crude to the Refining Department, transferred it at the posted field price. (A. 304-306). The posted field price was also utilized for purposes of computing depletion for federal income tax purposes, and for computing the severance tax due to producing states. This price was likewise used by producing states to determine the income allocable to the well head for state income or franchise tax purposes. (A. 393 and 431-432).

None of Appellant's natural gas went to the Refining Department for product conversion. The only gas that went to the Refining Department was used for fuel consumption and amounted to approximately four percent of Appellant's natural gas. All of the gas sold by Appellant was sold in the states where it was produced. The Natural Gas segment did not have any activities in the State of Wisconsin. (A. 328-330). All gas sold by Appellant to third parties was sold at a contract price negotiated with the purchaser. All gas purchased by Appellant was also purchased pursuant to negotiated contracts. Any internal transfer of gas by Appellant was based upon third-party contracts in effect at the time of the transfer. (A. 330-332).

Products transferred from Appellant's Refining Department to its Marketing Department were transferred on the basis of wholesale market prices or some equivalent value

usually based on prices quoted in Platt's Oilgram. Platt's Oilgram was a price service that primarily reported the wholesale market prices of various petroleum products at various points in the United States. These were prices of transactions between unrelated buyers and sellers and were prices at which products were actually changing hands in the trade. During the years 1965 through 1968 products transferred between the Refining Department and the Marketing Department were based on a formula tied to the price in Platt's Oilgram with a discount based upon a large third-party sales contract with Standard Oil of Kentucky. (A. 206-207 and 340-343). If for any day there was a change in the Platt's price for a product there would be a corresponding change in the transfer price between the Refining Department and the Marketing Department. (A. 346). All other products were also transferred at prices equivalent to third party arm's length prices. (A. 206-207).

The basic objective of Appellant's transfer pricing system was to provide a basis for valuing transfers which would approximate the same results as if one separate independent company had negotiated with another separate independent company. (A. 207).

F. Accounting Practices In The Petroleum Industry And The Use Thereof By Appellant.

As noted above, in the oil industry the posted field price was a figure at which crude oil was bought and sold in the market place. For accounting purposes that price was used as the measure of the sales value for crude oil. Multifunctional oil companies used posted field prices as a measure of value in transferring crude oil from their exploration and production functions to their refining departments. Without exception, the oil companies used posted field prices in this manner. These companies also used

transfer prices on natural gas which were related to existing third-party contracts. (A. 430).

For accounting purposes, to correctly and fairly determine the income of the exploration and production function, the use of posted field prices on transfers between exploration and production and refining gave a result equivalent to a third-party sale price. For transfers between refining functions and marketing functions of multifunctional oil companies, Platt's Oilgram was principally used to determine the transfer prices. Such a use provided an accounting result equivalent to a third-party sale price which was arm's length and fair and reasonable for accounting purposes. For internal accounting purposes, the functional operating departments of a multifunctional oil company were generally treated as separate functional segments. (A. 435-438).

Therefore, through the use of arms' length industry price indicators, Appellant's internal accounting and transfer pricing procedures isolated and supported the identification of: (1) income derived at the situs of production for the Exploration and Production Department; (2) income derived at the point of operation for the Refining Department; and (3) income derived at the point of operation for the Marketing Department. (A. 447-448).

From an accounting standpoint, there was no relationship between the income of the Exploration and Production Department and business done by Appellant in the State of Wisconsin. Under generally accepted principles of accounting, such income was fully earned or derived by the Exploration and Production Department at the point where the oil and gas was available for disposition. Under generally accepted principles of accounting, the Refining and Marketing Departments did not serve either to increase or to decrease the amount of Appellant's Exploration and Production functional income. (A. 389-390, 442 and 448-449).

SUMMARY OF ARGUMENT

1. The Wisconsin Supreme Court made a determination that because Appellant engaged in multiple functional operations on a multistate basis within a single corporate entity it was unitary *per se* and, hence, subject to having virtually its total corporate income included in the Wisconsin apportionment formula even though it merely engaged in a single function, very limited marketing activities, within the State of Wisconsin. Such a unitary *per se* concept was rejected in *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123 (1931), where this Court stated:

> ". . . [T]he fact that the corporate enterprise is a unitary one, . . . does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire net income may be taxed in one state regardless of the extent to which it may be derived from the conduct of the enterprise in another state." (283 U.S. at 133).

The *Hans Rees'* decision was in no way changed by the decision in *Butler Brothers* v. *McColgan*, 315 U.S. 501 (1942), for in *Butler Brothers* this Court simply indicated that the taxpayer had failed to carry the burden of showing by clear and cogent evidence that the formula of apportionment had resulted in the taxation of extraterritorial values.

This Court's most recent decision in the field of state income taxation was *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978), wherein this Court acknowledged that separate functional accounting may be used by a taxpayer to identify the income or profits from various phases or functions of a taxpayer's operations, and thereby establish that the income attributable to a given state

is "out of all appropriate proportion to the business transacted . . . in that state." (*Hans Rees' Sons, supra,* 283 U.S. at 135).

Appellant has established that none of the income from its Exploration and Production functional department was derived from any activities in the State of Wisconsin. As all of Appellant's Exploration and Production activities occurred outside the State, Wisconsin's attempt to tax any of the income from these activities resulted in a Due Process violation as both the elements of a minimal connection (nexus) and a rational relationship were lacking. (See *Moorman, supra,* 437 U.S. at 272-273).

2. The Wisconsin Department of Revenue and the Wisconsin Supreme Court have both acknowledged that the exploration and production of oil and gas is "mining" within the meaning of the Wisconsin statutes, and that such activities are situs operations. Nevertheless, the Department and the Wisconsin Supreme Court, by making a distinction between realized income and unrealized income of the Exploration and Production Department, have attempted to circumvent the Wisconsin statutes. There were no Exploration and Production Department activities in the State of Wisconsin. Consequently, there was no connection or nexus nor any rational relationship between such activities and those carried on by Appellant in the State.

Wisconsin tried to satisfy these two requirements by making a distinction between situs income as part of the "unitary stream" and situs income that did not enter the "unitary stream." This was an attempt in semantics to make a distinction which is not constitutionally defensible. Situs income, *i.e.,* income having relationship only to the state of the source of such income, cannot be divided for purposes of non-situs state taxation into unitary situs income and non-unitary situs income in order to avoid these constitutional requirements. See *National Bellas Hess, Inc.* v. *Department of Revenue,* 386 U.S. 753 (1967).

Appellant in the record below, established that the total income derived from its Exploration and Production Department was derived outside of Wisconsin. Any inclusion of that income in the Wisconsin apportionment formula resulted in overreaching and the taxation of operations beyond the borders of Wisconsin. Separate functional accounting, upon which the identification of Appellant's Exploration and Production situs income was established, was clearly authorized and approved by this Court in *Moorman, supra.* Consistent with prior decisions of this Court, the ruling against Moorman was due to the lack of an appropriate record to establish the income from its Iowa activities and from its Illinois activities. The record in this case, however, contains the proof lacking in *Moorman* and in *Butler Brothers,* and confirms that the application of the Wisconsin statutes by the Wisconsin Supreme Court has rendered those statutes unconstitutional under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

3. Since 1920 there has been a series of cases which has held that all oil and gas production income was taxable in the producing states. *Shaffer* v. *Carter,* 252 U.S. 37 (1920); *Magnolia Petroleum Co.* v. *Oklahoma Tax Commission,* 190 Okla. 172, 121 P.2d 1008 (1942); *Texas Company* v. *Cooper,* 236 La. 380, 107 So.2d 676 (1959); and *Webb Resources* v. *McCoy,* 194 Kan. 758, 401 P.2d 879 (1965). As reflected by these cases, the jurisdictions where Appellant's Exploration and Production activities occurred had the power to impose an income tax on Appellant's Exploration and Production income. When Wisconsin also imposed a tax on this income, the result was multiple

taxation which constituted a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

Both the Wisconsin Tax Appeals Commission (the trier of fact) and the Circuit Court on appeal found that the taxation of Appellant's Exploration and Production income by Wisconsin resulted in that income being subjected to multiple taxation. The multiple taxation doctrine makes it a violation of the Commerce Clause if a state, Wisconsin in this case, imposes a tax on the situs income derived from operations in another state, when that other state has the power to impose a tax on such operations, regardless of whether or not that power is exercised. This Court has confirmed that it is the *risk of* or the *potential burden of* multiple taxation that gives rise to a Commerce Clause violation and not just the actual fact of multiple taxation. See *e.g., J. D. Adams Mfg. Co.* v. *Storen,* 304 U.S. 307 (1938); *Standard Pressed Steel Co.* v. *Washington,* 419 U.S. 560 (1975). The Wisconsin Supreme Court, by allowing Wisconsin to tax Appellant's Exploration and Production activities, has condoned an application of the Wisconsin statutes that results in a violation of the multiple taxation doctrine and thereby violates the Commerce Clause of the United States Constitution.

ARGUMENT

I. The Wisconsin Supreme Court, By Finding That Appellant's Total Corporate Business Was Unitary As A Matter Of Law, Has Interpreted Wis. Stats. §71.07(2) In A Manner That Violates The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

Wis. Stats. § 71.07(2) reads, in part, as follows:

> "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business. . . ."

In interpreting this particular statutory provision, the Wisconsin Supreme Court relied primarily on the decisions of this Court in *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123 (1931) and in *Butler Brothers* v. *McColgan,* 315 U.S. 501 (1942), two cases based on utterly different factual records and producing utterly different taxation results. The Wisconsin Supreme Court, however, asserted that both of these cases stood for the proposition that:

> ". . . the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." (90 Wis.2d at 718, 281 N.W.2d at 104).

With this somewhat simplified view of the holdings in those two cases, and with the knowledge that only Appellant's Marketing Department engaged in activities in Wisconsin, the Wisconsin Supreme Court found, *as a matter of law,* that Appellant was a single corporate unitary business within the meaning of §71.07(2). This ignored and overruled the Commission's findings that Appellant's three principal operating departments, Exploration and Production, Refining and Marketing, were organized and operated as separate functional segments of Appellant's total corporate enterprise and were *each* unitary operations. (Findings of Fact Nos. 4 and 19; JS App. 67, 69). What the Wisconsin Supreme Court did was to make a determination that Appellant was engaged in the business of manufacturing and selling, and that it was, therefore, unitary *per se* and, hence, subject to having virtually its total corporate income included in the Wisconsin apportionment formula simply because of its very limited marketing activities in that State.

To support its unitary *per se* concept, the Wisconsin Supreme Court appears to have relied upon and did quote at length from an Oregon Tax Court decision which involved Appellant. *Humble Oil & Refining Co.* v. *Department of Revenue,* 4 OTR 284 (1971), is a decision with which Appellant disagrees, but, *more importantly and in any event,* the alleged "facts" and "conclusions" recited by the court in that case cannot be substituted for the record here, or for the findings of fact and conclusions of law by the Commission and by the Circuit Court in this case.

This unitary *per se* approach is certainly a novel one in state taxation, and does not pass constitutional muster under the Due Process Clause of the Fourteenth Amendment to the United States Constitution when compared

to all other decisions of this Court. Only four decisions of this Court have directly dealt with the "unitary" concept in connection with state taxation, and none of these decisions lends the slightest support to the Wisconsin Supreme Court's unique unitary *per se* concept.

In *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271 (1924), this Court was presented with a challenge to the constitutional validity of a New York statute providing for an annual franchise or privilege of doing business tax in New York on foreign corporations. This tax was measured by the net income of the corporation, and the tax was determined by the proportion of the value of certain assets within the state compared to the total value of all such assets located everywhere. This Court found that Bass, Ratcliff was engaged in the unitary business of manufacturing and selling ale, that the practice of manufacturing resulted in no profits until there were sales, and that as such the State Tax Commission was justified in attributing to New York for taxation a just proportion of the profits earned by Bass, Ratcliff from the unitary business. This Court pointed out that it did not believe that the application of New York's statutory taxation method produced an unreasonable result, was inherently arbitrary, or was an attempt to reach profits earned elsewhere. It was stressed that there was no evidence in the record to determine if Bass, Ratcliff had received any net income from its New York business or to determine the amount of any profit or loss on that business when either considered separately or together with the manufacturing business done in Great Britain. Notably, the controlling factor was the factual record, or lack thereof, on where the income was earned, not any basic "unitary" concept.

In *Hans Rees' Sons* v. *North Carolina, supra,* this Court considered a challenge to the North Carolina income tax

as assessed against Hans Rees' pursuant to a single-factor (property) apportionment formula. Hans Rees' was a New York corporation engaged in the business of tanning, manufacturing and selling leather. The taxpayer had a manufacturing plant located in North Carolina. Its sales office was located in New York. Sales were made throughout the United States and abroad. Some sales were also made in North Carolina. Hans Rees' established that the income from its business was derived from three sources: (1) buying profit, (2) manufacturing profit, and (3) selling profit. The record also established that for the years in issue, the average income with its source in the manufacturing and tanning operations within North Carolina was 17 percent. The State of North Carolina had, pursuant to its statutory method, for the years in question assessed between 66 and 85 percent of Hans Rees' income to the State. This Court was of the opinion that, when a corporation manufactures in one state and sells in another, the net profits of the entire transaction, as a unitary business, could not be attributed, *in disregard of the evidence,* to either state. In elaborating on this position this Court stated:

> "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits. The difficulty of making an exact apportionment is apparent, and hence, when the state has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases. But *the fact that the corporate enterprise is a unitary one,* in the sense that the ultimate gain is derived from the entire business, *does not mean* that for the purpose of taxation *the activities which are conducted in different jurisdictions are to be regarded as 'component parts of*

> *a single unit' so that the entire income may be taxed in one state regardless of the extent to which it may be derived from the conduct of the enterprise in another state.* As was said in the Bass Case with regard to 'the unitary business of manufacturing and selling ale' which began with manufacturing in England and ended in sales in New York, that state 'was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business.' And the principle that was recognized in National Leather Company v. Massachusetts, supra, was that a tax could lawfully be imposed upon a foreign corporation with respect to 'the proportionate part of its total net income which is attributable to the business carried on within the State.' When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a state has applied a method, which, albeit fair on its face, *operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction.*" (283 U.S. at 133-34; Emphasis added).

From the above quote, it is obvious that this Court rejected a unitary *per se* concept, a concept that has not been approved in any subsequent decisions. Nor has *Hans Rees'* been overruled or modified by this Court; it still stands as controlling law in state taxation cases involving apportionment and allocation of income derived from multistate operations.

In *Butler Brothers* v. *McColgan, supra,* the taxpayer contested an assessment under the California Franchise Tax, which is assessed against a corporation's net income as attributed to the state by an apportionment formula. Butler Brothers was an Illinois corporation qualified to do

business in California with its home office in Chicago, Illinois, and it was engaged in the wholesale dry goods and general merchandise business, purchasing from manufacturers and selling to retailers. It maintained a wholesale distributing house in California and all receipts from sales in California were credited to the San Francisco house for the period in question by deducting from the gross sales receipts in California the cost of such merchandise, the direct expenses of the San Francisco house and the indirect expense allocated to it. This resulted in a loss. The California Tax Commissioner, utilizing an apportionment formula consisting of property, wages and sales, allocated 8.1 percent of Butler Brothers' total corporate net income to California. The taxpayer contended that by use of this formula California had converted a substantial loss into a profit, and that the difference had either been created out of nothing or had been apportioned by California from other states. This Court did not accept Butler Brothers' position. In finding that Butler Brothers was a unitary business, relying primarily on *Hans Rees'* and *Bass, Ratcliff,* and in affirming the tax imposed by California, this Court stated:

> "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 688, 56 S.Ct. 625, 628, 80 L.Ed. 977. This Court held in Hans Rees' Sons, Inc. v. North Carolina, supra, 283 U.S. page 135, 51 S.Ct. page 389, 75 L.Ed 879, that that burden had been maintained on a showing by the taxpayer that *'in any aspect of the evidence' its income attributable to North Carolina was 'out of all appropriate proportion to the business' transacted by the taxpayer in that State.* No such showing has been made here." (315 U.S. at 507; Emphasis added).

This Court went on to stress that Butler Brothers had *not* shown the precise sources of its net income, and had *not* shown any factors responsible for that income being earned in states other than California. It was also emphasized that no showing had been made that income unconnected with the unitary business had been included in the formula by California. Thus, like Bass, Ratcliff, Butler Brothers lost because of a failure of proper proof.

This Court's most recent opinion regarding state taxation of an interstate business by means of an apportionment formula was rendered in *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978). Moorman, an Illinois corporation, was engaged in the manufacturing and sale of animals feeds. It sold products to Iowa customers through salesmen and from warehouses in that state. All of the product was manufactured in Illinois. The Iowa apportionment formula is a single-factor formula utilizing sales. Under the Iowa statute the income attributable to Iowa is determined by first eliminating income allocable to other states. From the remaining income, that attributable to business done in Iowa is calculated by applying to the remaining income a fraction obtained from taking that proportion of the gross sales made within the state to total gross sales. Moorman challenged the constitutionality of the Iowa single-factor formula, and the trial court held the formula invalid under the Due Process and Commerce Clauses of the United States Constitution. The Supreme Court of Iowa reversed, and the case then came before this Court. This Court, in responding to Moorman's contention that Iowa's single-factor formula resulted in the taxation of extraterritorial income in violation of the Due Process Clause, stated:

> "Appellant does not suggest that it has *shown* that a significant portion of the income attributed to Iowa in fact was generated by its Illinois operations; *the*

record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations.'' (437 U.S. at 272; Emphasis added).

Further on in its opinion this Court stated:

> ''The Iowa statute afforded appellant an opportunity to demonstrate that the single-factor formula produced an arbitrary result in its case. But *this record contains no such showing* and therefore the Director's assessment is not subject to challenge under the Due Process Clause.'' (Footnote omitted). (437 U.S. at 275; Emphasis added).

Thus, Moorman also failed for lack of a record showing the source of its income to be extraterritorial to the State of Iowa.

In the above quotations from *Moorman,* this Court, consistent with *Hans Rees'*, has set forth the framework necessary to establish a Due Process violation for a multistate business challenging a state's apportionment formula. *Moorman* thus acknowledges that separate functional accounting may be used by a taxpayer to identify the income or profits from the various phases or functions of the company's operations and thereby establish that the income attributed to a given state is ''out of all appropriate proportion to the business transacted . . . in that state.'' *Hans Rees' Sons, supra,* 283 U.S. at 135. It should be noted that the Wisconsin Supreme Court rejected this functional accounting approach by stating that it was merely *dicta,* thus ignoring this Court's prescription for testing a Due Process challenge to a state's method of apportionment. In the record, Moorman made *no* attempt to establish the profits or income of its manufacturing operation in Illinois; it only compared the results produced by Iowa's single-factor (sales) formula with those produced by the typical three-factor (sales, payroll and property) formula,

which was not ''evidence'' but a mere exercise in arithmetic. (See Iowa Supreme Court opinion, 254 N.W.2d 737, 750). Without a proper evidentiary record, this Court had no alternative but to find that Moorman had not shown that Iowa had taxed extraterritorial income.

In the present case Appellant has done exactly what this Court indicated Moorman should have done in order to establish the taxation of extraterritorial income. By separate functional accounting, Appellant has shown the net income for all three of its principal functional operations. In Schedule A to Exhibit 28 (A. 760) Appellant set forth its Wisconsin results for the years in issue computed by four different accounting methods:

(1) On a separate, geographical accounting basis;

(2) On a taxable income and tax basis if apportionment was used for its Marketing function alone;

(3) On a taxable income and tax basis if apportionment was used for its combined Marketing and Refining functions; and

(4) On a taxable income and tax basis if apportionment was used after the allocation of income from the Exploration and Production function to situs.

The fourth computation above shows that there is a spread of approximately 2.5 million dollars between the income taxable by Wisconsin if Exploration and Production income is allocated to situs and the income the State here attempts to pull in and tax under its apportionment method, or an increase of 76 per cent in alleged taxable income and an increase of 75.6 per cent in alleged taxes due.

In addition, the testimony of Appellant's witnesses established that Appellant's operational functions were conducted and were accounted for as separate segments of its

total enterprise (Findings of Fact No. 4, JS App. 67), and that the Exploration and Production Department income was all earned outside of Wisconsin from activities outside Wisconsin (Findings of Fact Nos. 11 and 18, JS App. 68, 69). The Department (of Revenue) offered no contrary evidence. By functional separate accounting, and also by separate accounting for Wisconsin operations, Appellant has proven that extraterritorial income from its Exploration and Production Department operations was included in the Wisconsin apportionment formula, thereby resulting in a Due Process Clause violation.

Moreover, the fact that Wisconsin's apportionment formula, as applied by the Department, attempts to tax income out of all appropriate proportion to the business transacted by Appellant in the State is conclusively demonstrated by Exhibit 29 (JS App. 87). This shows that Appellant earned a 3.2 percent average return on sales during the years in issue in its company-wide marketing operations, which included both the more profitable "mature areas" and the less profitable and unprofitable "expansion areas." All the testimony and the separate accounting, which the Department's witnesses acknowledged they could not refute (A. 627-635), indicated that Wisconsin was in the expansion marketing area classification and unprofitable.

The viability of the separate accounting was shown by testimony and Exhibit 27 (A. 758), which proved that the cost ingredients were separately determined for Wisconsin with only an administrative overhead calculation being allocated, and that, even by eliminating this allocation, no material taxable income was created (A. 365-368). Despite this, the Department's assessment attributes to Wisconsin marketing (Appellant's only Wisconsin activity), an average return for the years in issue equal to 7.5 percent of sales, which is approximately 2½ times the company-wide experience including the profitable mature areas for the same period.

What could better demonstrate factually that the Department's assessment is an overreach which subjected to Wisconsin taxation income out of all appropriate proportion to the business transacted by Appellant in the State? Thus, when considered with the unrefuted functional and Wisconsin separate accounting results, Appellant has succeeded under this Court's *Moorman* criteria in establishing an unconstitutional overreach. This Court's prescription in *Moorman,* which the Wisconsin Supreme Court chose to ignore, has been clearly filled to the requisite standard by Appellant's record in the present case.

Therefore, within the framework established by this Court in *Bass, Ratcliff, Hans Rees', Butler Brothers* and *Moorman,* the decision of the Wisconsin Supreme Court and its unitary *per se* concept cannot stand. None of these decisions has reached a finding of unitary *per se.* A finding of unitary at the very most provides merely a condition precedent to the right to apply an apportionment formula to the income of that so-called unitary business, providing that the taxpayer is unable to show either that all or part of that income is not subject to taxation as not being attributable to business done in the state, or that the resulting tax is out of all proportion to business conducted in the state. In *Bass, Ratcliff, Butler Brothers* and *Moorman* the taxpayer's proof was not sufficient to overcome the condition precedent. However, in *Hans Rees'* it was, and this Court struck down North Carolina's method of taxation as unconstitutional. With Appellant's record, the same result must occur here.

The opinion of the Wisconsin Supreme Court has even less constitutional validity when the facts in *Bass, Ratcliff, Hans Rees', Butler Brothers* and *Moorman* are compared

to those in the present case. *Bass, Ratcliff, Hans Rees'* and *Moorman* involved businesses engaged in manufacturing and selling, and *Butler Brothers* was a business engaged in purchasing and selling. None of these cases concerned a vertically integrated petroleum company operating under the principle of functional profitability independence, as is more specifically described in the Statement of the Case. Appellant's separate functional structure (Finding of Facts Nos. 4, 19, JS App. 67, 69), with its separate internal functional and Wisconsin accounting, makes the unitary *per se* concept expressed by the Wisconsin Supreme Court wholly indefensible.

This is further shown by testing the Wisconsin assessment against the two elements of Due Process, a minimal connection and a rational relationship (*Moorman, supra,* 437 U.S. at 272-273). Proper analysis should separate the "integral part of a unitary business" phrase in Wis. Stats. §71.07(2) into two parts. "Unitary" is a description of the business itself, while "integral part" is the relationship of Wisconsin activity to out-of-state activity. The latter directly invokes the "rational connection" element of Due Process, and this is one of the issues upon which this Court should focus.

Neither the Department nor the Wisconsin court has distinguished the two elements of the statutory phrase. In fact, the court utilized a test from *Interstate Finance Corp.* v. *Dept. of Taxation,* 28 Wis.2d 262, 269, 137 N.W.2d 38, 41-42 (1965), which in turn was taken from Altman & Keesling, *Allocation of Income In State Taxation* 101 (2d ed. 1950), which states that:

> ". . . the essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary."

While stated as the test for "unitary", this definition really focuses on the "integral part" portion of the statutory phrase, and indicates that either dependence *or* contribution will satisfy the test. It should be noted that the original author of this test subsequently changed his view to dependence *and* contribution. Keesling and Warren, *The Unitary Concept,* 12 Hastings L.J. 42, 46, 48 (Aug. 1960).

The Wisconsin court found Appellant to be unitary as a matter of law without any discussion of the integral part element, this despite trial court findings of fact as to *no economic dependence* between Appellant's Wisconsin marketing and its Exploration and Production or its Refining functions (Findings of Fact Nos. 21 and 23, JS App. 69), and as to *no integral relationship* existing between Wisconsin marketing and Appellant's Exploration and Production and its Refining functions (Findings of Fact Nos. 20 and 22, JS App. 69). Thus, the court in effect held that contribution *alone* is sufficient rational relationship for taxation. Also, it either assumed that Wisconsin marketing made a positive contribution to Appellant, contrary to the unrefuted evidence from separate accounting that Appellant incurred substantial losses in Wisconsin, or it held that even a negative contribution satisfies the test.

As part of the Due Process issues presented, this Court should address the constitutional appropriateness of utilizing mere contribution, particularly negative contribuiton, to establish the existence of a rational relationship, and thereby satisfy this Due Process requirement. It is submitted that mere contribution is not a constitutionally appropriate test, and that the proper test for the rational relationship element of Due Process should involve the question of whether the in-state activity is "necessary" to one or more of the taxpayer's out-of-state functional

operations; and if this finding is affirmative, then apportionment may be utilized as to *only* those functional operations of the taxpayer where this rational relationship exists. This standard would recognize that a corporate taxpayer may have more than one functional business within its corporate shell, and for a state to apportion total corporate income there must be a rational relationship between the state and *each* functional business. Otherwise, the state can only apportion corporate income from those functional segments where such a relationship exists.

II. The Assessment Of Wisconsin Tax On Income Derived From Appellant's Exploration And Production Functional Operations Outside The State From Extraction Of Oil And Gas Not Sold To Third Parties At The Well Head Constitutes A Construction Of Wis. Stats. §§71.07(1) and (2) Which Violates The Due Process Clause Of The Fourteenth Amendment To the United States Constitution.

The Wisconsin Supreme Court upheld the Department's interpretation of the situs income exclusion contained in Wis. Stats. §§71.07(1) and (2) "to apply only to income derived from sales to third parties at or near the well head." (90 Wis.2d at 705, 281 N.W.2d at 97.) By this ruling, the Wisconsin Court adopted the "barrel formula" applied by the Department in its audit of Appellant. This barrel formula was devised and utilized by the Department to reflect its belief that crude oil sold to third parties at the well head was situs income requiring allocation under the Wisconsin statutes, and that income derived from crude oil produced by Appellant and transferred to its Refining Department was not so allocable but rather was required to be included in apportionable income. This barrel formula was very complex in nature, was based on a variety of assumptions (A. 399-403; Exhibits 1 and 31, A. 601-627

and 791-798), was admitted to be the product of the imagination of an employee of the Department, and was not founded upon the Wisconsin statutes or upon any rules or regulations of the Department. (A. 74-75, 80 and 121-122). In addition, the separation attempted by the Department was an impossible one, for Appellant both bought and sold crude oil and the crude oil that went to its Refining Department completely lost its identity due to commingling of produced crude and purchased crude.

The Department's "barrel formula" does not find support in the only statutory reference to situs income contained in §§71.07(1) and (2). The relevant provisions of §71.07(1) read as follows:

> "For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss *derived* from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, *mine* or quarry, or from the sale of real property or tangible personal property *shall follow the situs of the property from which derived.*" (Emphasis added).

Section 71.07(2) provides, in pertinent part, as follows:

> "In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: . . . there shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient. . . ."

The Department and the Wisconsin Supreme Court have acknowledged that the exploration and production of oil and gas is "mining" within the meaning of Wis. Stats. §71.07(1), and that such activities are situs operations (see JS App. 21). The Department by means of the "barrel formula", and the Wisconsin Supreme Court by approving

the same, have attempted to circumvent the mandate of the Wisconsin statutes, which requires all income "derived" from oil and gas exploration and production to be allocated to situs, and which thereby eliminates such situs income from apportionable income.

In the trial record Appellant established that, pursuant to its accounting practices and those of the industry, all of the income of its Exploration and Production Department was calculated from actual market place sales of crude oil to third parties at the posted field price or from internal transfers between Appellant's Exploration and Production Department and its Refining Department which transfers were based upon the posted field prices utilized in the industry. The record also established that the posted field prices were bona fide market prices. Therefore, all internal transfers of crude oil by Appellant were made at the posted field price for the particular grade and field from which the crude was produced, as if that crude had been sold to a third party in the open market place. Furthermore, the record established that the crude oil which went to Appellant's Refining Department was produced completely outside of Wisconsin. Appellant's total Exploration and Production functional income, therefore, was derived at the situs of the exploration and production activities and, under the Wisconsin statutes, was required to be so allocated and not apportioned, as all such activities occurred outside of Wisconsin. Schedule A of Exhibit 28 (see Appendix I, JS App. 86) sets forth the taxable income and tax attributable to Wisconsin with Exploration and Production functional income allocated to situs, and shows a difference in favor of the State in taxable income from the State audit of $2,574,526 and a resulting difference in tax from that audit of $180,217. Such additional tax imposed by the State was simply the result of an unconstitutional overreach.

This Court, in *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959), held that the net income of the interstate operations of a foreign corporation may be subjected to state taxation provided the tax is not discriminatory and is properly apportioned to activities within the taxing state forming sufficient nexus to support the tax. And it seems clear from *National Bellas Hess, Inc.* v. *Department of Revenue,* 386 U.S. 753 (1967), that a state may not impose a tax unless there is some minimum connection between the particular activities of the taxpayer in the taxing state with identical or similar activities of the taxpayer outside the taxing state.

It should be noted at this point that Appellant is not raising the question of the right of the State of Wisconsin to tax income derived *in* that State from the operations of a multistate business, nor the validity of Wisconsin's three-factor formula *when properly applied.* However, in subjecting virtually all of Appellant's Exploration and Production functional income to apportionment by Wisconsin, the Wisconsin Supreme Court has ignored the nexus requirement of *National Bellas Hess* and *Northwestern States.* There were no Exploration and Production functional activities in Wisconsin, so there could be no connection between such activities and the State. Wisconsin tries to satisfy the nexus requirement by making a distinction between situs income as part of the "unitary stream" and situs income that does not enter the "unitary stream." This is clearly an attempt in semantics to make a distinction which is not constitutionally defensible. Situs income, *i.e.,* income having relationship only to the state of the source of such income, cannot be divided for purposes of non-situs state taxation into unitary situs income and non-unitary situs income in order to avoid the constitutional nexus requirement.

Appellant is aware of no decision of this Court involving application of an apportionment formula to operational situs income earned outside the taxing state. However, this Court has dealt with a somewhat parallel problem involving the assessment of *ad valorem* property taxes against multistate businesses. In *Norfolk and Western Railway Co.* v. *Missouri State Tax Commission,* 390 U.S. 317 (1968), the taxpayer challenged Missouri's *ad valorem* property tax assessed against its total value of railroad rolling stock based upon a mileage formula calculated as the ratio of the total number of miles of road in Missouri to the total miles of the road owned by the taxpayer everywhere. The taxpayer submitted evidence showing that the actual value of all its rolling stock in the state on the tax day was actually about 38% of the figure calculated by the state through its formula. The taxpayer also submitted evidence showing that the tax day inventory was a normal daily inventory of its rolling stock in the state. This Court found that the tax as applied by Missouri was invalid as casting that State's tax burden upon property located beyond the borders of the State. This Court indicated that the taxpayer had satisfied the burden of proving that the application of the mileage formula had resulted in gross overreaching beyond the values represented by the intrastate assets purported to be taxed and thereby had violated the Due Process and Commerce Clauses of the United States Constitution, by stating:

> "*A State will not be permitted,* under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, *to 'project the taxing power of the state plainly beyond its borders.'* Nashville, C. & St. L.R.Co. v. Browning, 310 U.S. 362, 365, 60 S.Ct. 968, 970, 84 L.Ed. 1254 (1940). Any formula used must bear a *rational relationship,* both on its face and in its application, to property values connected with the taxing State. Fargo v. Hart, 193 U.S. 490, 499-500, 24 S.Ct. 498, 500, 48 L.Ed. 761 (1904)." (Footnote omitted). (390 U.S. at 325; Emphasis added).

Just as the taxpayer in *Norfolk* showed the actual value of property in the state to establish an overreaching in taxation of property located outside of Missouri, Appellant here has established the total value of the income derived from its Exploration and Production Department, all outside of Wisconsin, and has established that the inclusion of any of that income in Wisconsin's apportionment formula (resulting in additional income apportioned to Wisconsin of $2,574,526) results in overreaching and taxation of operations beyond the borders of the State of Wisconsin.

In addition, the general prohibitions set forth in *Hans Rees', supra,* are also controlling to prevent the taxation of Appellant's Exploration and Production situs income, as this would otherwise result in unreasonably and arbitrarily attributing to Wisconsin "a percentage of income out of all appropriate proportion to the business transacted by the appellant in that state." (283 U.S. at 135). This clearly violates the rational relationship Due Process requirement.

It further should be emphasized that separate functional accounting, upon which the identification of Appellant's Exploration and Production situs income is established, was clearly authorized and approved by this Court in *Moorman:*

> "Appellant does not suggest that it has shown that a significant portion of the income attributed to Iowa in fact was generated by its Illinois operations; the record does not contain any separate accounting analysis showing what portion of appellant's profits were attributable to sales, to manufacturing, or to any other phase of the company's operations." (437 U.S. at 272).

Such prescribed functional accounting is clearly present in the record here. In addition, separate accounting for Wisconsin operations is available to corroborate the obvious conclusion that extraterritorial income is being taxed by the State of Wisconsin. See Part I of this brief, *supra*, and particularly Schedule A to Exhibit 28 (A. 760; JS App. 86).

The Wisconsin Supreme Court asserted that the above language from the *Moorman* decision was merely *dicta* and that the idea of separate functional accounting seemed to be incompatible with the concept of formula apportionment. In this regard it cited as the only authority, Hellerstein, *State and Local Taxation* (3d ed. 1969) (see JS App. 24). Clearly, this Court's recent language in *Moorman* expresses the Court's acknowledgement that separate functional accounting can be an accurate means of determining whether or not there has been a Due Process violation in apportionment formula situations, so Hellerstein's ten year old treatise cannot be cited as an authority in the context of this case.

The quote from Hellerstein relied on by the Wisconsin Supreme Court, to disregard Appellant's functional accounting record, reflects the observation, expressed in numerous decisions of this Court and of lower courts, that there is great difficulty in separating out the manufacturing profit from the selling profit of a multistate business that manufactures in one or more states and then sells in one or more other states. Thus, an apportionment formula, which is designed to assign to a given state that portion of net income reasonably attributable to business done in that state, will be preferred to some type of geographical separate accounting. *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff, supra; Hans Rees', supra; Butler Brothers, supra; Northwestern States, supra;* and *Moorman, supra.*

Without exception, all of the cases adopting the above reasoning have involved taxpayers engaged in manufacturing or purchasing and then selling. And, until *Moorman*, one of the basic principles emerging from these cases was the recognition of the apparent impossibility to identify the precise sources of net income derived from a multistate business engaged in manufacturing and selling. Therefore, states were given considerable leeway in adopting apportionment formulas to tax the income of such multistate businesses. *International Harvester Co.* v. *Evatt*, 329 U.S. 416 (1947). But due to the organizational structure and operation of Appellant, with its separate functional operating departments and the sophistication of its accounting procedures, the reasoning of these earlier decisions is not applicable in the present case. In sharp contrast, Appellant's Exploration and Production function is not part of and is completely different from a manufacturing and sales business. Oil and gas exploration and production involves the finding and extraction of minerals in place, minerals that are assets uniquely associated with a particular state, the state of production.

This Court further acknowledges the validity of functional accounting by its statement in *Moorman* that:

> "The Iowa statute afforded appellant an opportunity to demonstrate that the single-factor formula produced an arbitrary result in its case. But this record contains no such showing and therefore the Director's assessment is not subject to challenge under the Due Process Clause." (437 U.S. at 275).

In footnote no. 9 at the end of the above paragraph, this Court refers to the concurring opinion of Justice McCormick of the Iowa Supreme Court, and sets forth in this footnote the following quote from that opinion:

> "In the present case, Moorman did not attempt to prove the amount of its actual net income from Iowa

> activities in the years involved. Therefore no basis was presented for comparison of the corporation's Iowa income and the income apportioned to Iowa under the formula. *In this era of sophisticated accounting techniques, it should not be impossible for a unitary corporation to prove its actual income from activities in a particular state.*" (437 U.S. at 275; Emphasis added).

Consequently, this Court has now recognized that a taxpayer's accounting procedures may be sufficient to establish a Due Process violation.

Appellant's separate functional accounting, as set forth in the record before the Commission, isolated and identified all of the income derived and fully earned at the situs of production for the Exploration and Production Department. In all instances these locations were in states other than Wisconsin.

The record in this case, therefore, contains the proof lacking in *Moorman,* in *Butler Brothers* and in *Bass, Ratcliff*. That proof is confirmed by the following three Findings of Fact by the Commission (see Appendix C at JS App. 67-69) which were not challenged by the Department at either the Circuit Court or the Supreme Court of Wisconsin level:

> "4. The petitioner's three principal operating departments, exploration and production, refining, and marketing, were organized and operated as separate segments and separate functional operations of the petitioner's total corporate enterprise."
>
> "10. The petitioner utilized internal transfer prices between its functional departments that were the equivalent of third-party competitive prices."
>
> "18. During the period involved herein, income derived from each of the petitioner's functional operating departments could be determined from the petitioner's books and records."

The Wisconsin Supreme Court, in an attempt to discount the record made by Appellant, has made a distinction between "realized" income, *i.e.,* that resulting from sales to third parties, which it concludes is situs income outside of the unitary stream, and "derived" income, *i.e.,* transferred internally at posted field prices, which it considers to be within the unitary stream, despite the fact that the Wisconsin statute, §§71.07(1) and (2), uses only the term "derived" to apply to both situations. Thus, the Wisconsin Supreme Court has written into the statute a distinction which does not exist in the statutory language.

Certainly no such distinction has ever been made by this Court. Indeed, this Court has never recognized that only "realized" income can be used for determining taxable income. On the contrary, this Court has used such words as "attributable to" (*Hans Rees'*), "derived" (*Butler Brothers*) and "earned" (*Moorman*) to describe taxable income. In short, the Wisconsin Supreme Court cannot, upon the pretext of dividing situs income between unitary and non-unitary or between realized and derived, attempt to avoid the constitutional prohibitions against taxing income that has no rational relationship to the taxing state. A repeat of a quote already set forth in Part I of this brief, *supra,* is most appropriate to the present situation:

> "But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purposes of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire net income may be taxed in one state regardless of the extent in which it may be derived from the conduct of the enterprise in another state." (*Hans Rees', supra,* 283 U.S. at 133).

At this point, it is interesting to note that the Wisconsin Supreme Court by making a distinction between realized income and derived income has in effect, without so acknowledging, overruled two of its earlier decisions. In *Standard Oil Co.* v. *Wisconsin Tax Commission,* 197 Wis. 630, 223 N.W. 85 (1929), the Wisconsin Supreme Court was presented with the position by the State that:

> "A person realizes a profit or loss on the sale of product when such product is disposed of. To anticipate departmental profits in advance of sale of the product by taking a manufacturing profit, a transportation profit, or a selling profit at different stages and times, is arbitrary." (197 Wis. at 636, 223 N.W. at 88).

The response by the Wisconsin Supreme Court to the contrary was sharp and clear:

> "Nor do we find anything in *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113, 41 Sup.Ct. 45, inconsistent with our conclusion in this case. There, there was no separation on the basis of market value between the operations of the manufacturing department and the sales department as there is in this case. We perceive no reason why, under the facts in this case, the profits *derived* from the sales operations should not be ascertained, so far as plaintiff is concerned, as they would be if the sales operations were conducted by a separate corporate entity. In either case the profits are *earned* at the same time and place. (197 Wis. at 639, 223 N.W. at 88-89; Emphasis added).

In *Kansas City Star Co.* v. *Wisconsin Department of Taxation,* 8 Wis.2d 441, 99 N.W.2d 718 (1959), the Wisconsin Supreme Court upheld the right of a taxpayer to utilize intra-company transfer prices, which were based on prices used in the industry in third-party transactions, for purposes of determining the corporation's divisional income in Wisconsin. The reasoning in the *Kansas City Star* and *Standard Oil* cases is sound and highlights the Due Process

violation resulting from the Wisconsin Supreme Court's decision in the present case.

This Due Process violation is brought about by the Wisconsin Supreme Court holding that income derived from Appellant's Exploration and Production functional operations outside of Wisconsin, consisting of the extraction of oil and gas not sold to third parties at the well head, was required to be included in apportionable income. Such a violation is confirmed by decisions from other jurisdictions.

The Minnesota Supreme Court in *Skelly Oil Company* v. *Commissioner of Taxation,* 269 Minn. 351, 131 N.W.2d 632 (1964), concluded that the exploration and production, refining and marketing functions of Skelly were operated as separate businesses. Further, it was concluded that because posted field prices were competitively established, were employed for federal depletion, severance tax, production states' income tax and royalty payment purposes, and were utilized as the prices for which the taxpayer bought and sold crude oil, they constituted a bona fide base for internal transfer pricing from production to refining. Adding this all together, the Minnesota Supreme Court held that only marketing income was exposed to taxation as this was the only function being carried on in Minnesota, and that the unitary concept was inapplicable. The Minnesota Supreme Court distinguished *Butler Brothers, supra,* with the following observation that is equally applicable to this case:

> "As was emphasized in the *Butler Brothers* case, a state may tax only income 'created by business within its borders.' Clearly, the fact that Skelly's production income is fully earned at the point where the crude oil is produced and is neither more nor less than what it would be if Skelly had no refineries, distinguishes the situation here from that case. (269 Minn. at 373, 131 N.W.2d at 646).

That court then concluded:

> "Skelly's sole activity in Minnesota is the marketing of finished products, as the proof clearly shows. The only permissible conclusion is that taxes based on the inclusion of production income, no matter what the percentage, in apportionable income are beyond the state's authority. Minnesota may include in the apportionable income subject to its tax only income attributable to Skelly's marketing activity." (269 Minn. at 373, 131 N.W.2d at 646).

In *Tenneco, Inc.* v. *Barr,* 224 So.2d 208 (Miss. 1969), the taxpayer operated a gas transmission system, part of which was situated in Mississippi and a gas exploration and production function carried on outside Mississippi. The former operated at a profit and the latter at a loss. The taxpayer sought total apportionment on the unitary theory. The Mississippi Supreme Court held the transmission business alone to be unitary and subject to apportionment, but found that the gas exploration and production operations were not unitary with or an integral part of the transmission operations, and hence, separate accounting applied to those functions.

The Circuit Court of Appeals of the Eighth Circuit, in *Standard Oil Co.* v. *Thoresen,* 29 F.2d 708 (8th Cir. 1928), held that under the law of North Dakota the plaintiff oil company was not required to pay North Dakota taxes on its producing and refining oil business done only in other states simply because it engaged in the business of marketing refined products in North Dakota. The Eighth Circuit was of the opinion that any statute of a state which attempted to tax income from property located in another state was void as being beyond the power of the taxing state.

Furthermore, the supreme courts of three oil and gas producing states have addressed this issue, and have held

that the income from oil and gas production was allocable to situs and taxable in each respective producing state, regardless of whether or not the taxpayer corporation was unitary or whether the income was actually realized or was derived from a fair market value computation. *Magnolia Petroleum Co.* v. *Oklahoma Tax Commission,* 190 Okla. 172, 121 P.2d 1008 (1942); *Texas Company* v. *Cooper,* 236 La. 380, 107 So.2d 676 (1959); *Webb Resources* v. *McCoy,* 194 Kan. 758, 401 P.2d 879 (1965).

Therefore, by creating two categories of situs income out of Appellant's Exploration and Production functional income, one being taxable and one not, the Wisconsin Supreme Court has rendered §§71.07(1) and (2) unconstitutional under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

In addition, the Wisconsin Supreme Court's Due Process analysis is further substantially deficient. The court said Appellant's activities had a "substantial nexus" with the state based solely upon sales volume by *its* Marketing Department (only) during the years in issue (90 Wis.2d at 729, 281 N.W.2d at 110; JS App. 29). This superficial analysis ignores the fundamental principles embodied in the Due Process Clause, namely, that the concept requires that there be some minimal connection between the activities taxed and the taxing state, and that the income attributable to the state for tax purposes be rationally related to values connected with the state. *Moorman, supra,* 437 U.S. at 272-273. The Wisconsin court's reasoning, that situs income can be taxed because it enters the "unitary stream", overlooked the rational relationship principle because it pulled in for Wisconsin taxation situs activities unrelated to Wisconsin and thereby subjected to taxation income out of all appropriate proportion to Appellant's Wisconsin activities.

The Wisconsin Supreme Court also supported the Department's assertion that it was entitled to its "fair share" of Appellant's income, and made reference to the fact that Wisconsin sales for the four years in issue represented .41 percent of Appellant's total sales and that Wisconsin assessed taxable income for these same years represented .22 percent of Appellant's total company income adjusted to a Wisconsin basis. Thus, the court appears to have applied a *de minimus* test to justify the taxation of a "fair share" of Appellant's income. In other words, since the assessed taxable income is so small compared to total company income, the resulting tax is conclusively presumed to be valid. There is no authority to support this position, for such "fair share" percentages cannot be invoked to obscure the 76 per cent increase in taxable income and the 75.6 per cent increase in taxes upheld by the Wisconsin Court's unitary *per se* concept (see above at p. 25). The tax imposed by Wisconsin must still pass *all* the constitutional tests imposed by the decisions of this Court regardless of the amount of taxable income apportioned to the taxing state. See *Northwestern States, supra; National Bellas Hess, supra; Hans Rees', supra;* and *Moorman, supra.*

Thus, this "fair share" approach ignores the essential Due Process concept of rational relationship; and the attempted employment of a "unitary stream" theory, while creative, cannot serve to bootstrap income with an undeniable situs in other states into Wisconsin for taxation purposes. The constitutional principles are not that elastic, and the essential rational relationship to tax Appellant's Exploration and Production functional income is missing here.

III. The Assessment Of Wisconsin Tax On Income Derived From Appellant's Exploration And Production Functional Operations Outside The State From Extraction Of Oil And Gas Not Sold To Third Parties At The Well Head Constitutes A Construction Of Wis. Stats. §§71.07(1) And (2) Which Violates The Commerce Clause Of Article One Of The United States Constitution.

Since 1920 there has been a series of cases which has held that all oil and gas production income was taxable in the producing states. *Shaffer* v. *Carter,* 252 U.S. 37 (1920); *Magnolia Petroleum, supra; Texas Company, supra; Webb Resources, supra.* As reflected by these cases, the jurisdictions where Appellant's exploration and production activities occurred have the power to impose an income tax on Appellant's Exploration and Production net income. Where other states such as Wisconsin also imposed a tax, this resulted in multiple taxation of that income and constituted a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

The Commission found, based upon the testimony of various witnesses, that the taxation of Appellant's Exploration and Production income by Wisconsin resulted in that income being subjected to multiple taxation (see Appendix C, JS App. 71, Finding of Fact no. 33). On appeal the Circuit Court sustained this finding (see Appendix B, JS App. 41). The Wisconsin Supreme Court neatly sidestepped this finding by ignoring the foregoing income tax cases and observing, but without citing any authority, that the taxes imposed by the situs states might be imposed on production rather than on income, thus, in its view, eliminating any question as to multiple taxation or burden on interstate commerce. The precise language is:

> "The fact that the producing states may impose production taxes which are a form of property tax or severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income." (Footnotes omitted) (90 Wis.2d at 731, 281 N.W.2d at 110-11).

The compelled inferences from the foregoing are that multiple taxation as a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution occurs only (a) if a situs state having the power to tax situs operations actually exercises that power, and (b) if the situs state does exercise its taxing power, the type of tax imposed must be of the same type as that imposed by the non-situs, apportioning state. This utterly ignores the basic propositions that a violation of the Commerce Clause occurs if a state, Wisconsin in this case, imposes a tax on the situs income derived from operations in another state if that other state has the *power* to impose a tax on such operations, regardless of whether or not that power is exercised.

This Court has, in a series of decisions, confirmed that it is the *risk* of or the *potential burden* of multiple taxation that gives rise to a Commerce Clause violation and not just the fact of multiple taxation. *J.D. Adams Mfg. Co.* v. *Storen,* 304 U.S. 307 (1938); *Gwin, White & Prince, Inc.* v. *Henneford,* 305 U.S. 434 (1939); *McLeod* v. *J.E. Dilworth Co.,* 322 U.S. 349 (1944); *Freeman* v. *Hewit,* 329 U.S. 249 (1946); *Central Railroad Co.* v. *Pennsylvania,* 370 U.S. 607 (1962); *General Motors Corporation* v. *Washington,* 377 U.S. 436 (1964); *Evco* v. *Jones,* 409 U.S. 91 (1972); *Standard Pressed Steel Co.* v. *Washington,* 419 U.S. 560 (1975); *Austin* v. *New Hampshire,* 420 U.S. 656 (1975). Thus, this principle is well documented in the decisions of this Court. In *McLeod* v. *Dilworth Co., supra,* the multiple taxation doctrine was defined:

> ". . . the state may not impose certain taxes on interstate commerce . . . because other states also may have the right constitutionally, apart from the commerce clause, to tax the same thing and either the actuality or the *risk* of their doing so makes the total burden cumulative. . . ." (322 U.S. at 358; Emphasis added).

As recently as 1975 this Court reaffirmed this doctrine. In *Standard Pressed Steel Co.* v. *Washington, supra,* this Court quoted from its opinion in *Gwin, White & Prince, Inc.* v. *Henneford, supra,* as follows:

> " '. . . The present tax, though nominally local, thus in its practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, the *risk* of a multiple burden to which local commerce is not exposed.' " (419 U.S. at 564; Emphasis added).

Also in 1975, this Court made clear that the multiple taxation doctrine applies to preclude taxation by a state of income properly taxable by another state, whether or not the other state is currently exercising that power. In *Austin* v. *New Hampshire, supra,* this Court struck down New Hampshire's taxation of Maine residents who worked in New Hampshire, stating:

> "Nor . . . can the constitutionality of one State's statutes affecting nonresidents depend upon the present configuration of the statutes of another State." (420 U.S. at 668).

This principle was carefully explained by Mr. Justice Frankfurter in *Freeman* v. *Hewit, supra,* stating:

> ". . . But that, for the time being, only one State has taxed is irrelevant to the kind of freedom of trade which the Commerce Clause generated. The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment." (329 U.S. at 256).

Thus, it clearly is the *power* to tax the income in issue, not the actuality of taxation which controls. Here there can be no question that situs states, where Appellant's Exploration and Production functional activities were conducted, have the right to tax the net income derived therefrom; and for other states, such as Wisconsin, to also impose a tax on such income invokes the multiple taxation doctrine. Furthermore, contrary to the implication of the Wisconsin court's decision, the labels and phraseology employed by other taxing states are irrelevant, for this Court has emphasized that economic realities, not labels and phraseology, determine whether or not a tax on interstate activities is constitutional. *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 (1977).

In the *Moorman* decision, *supra,* this Court dealt summarily with the taxpayer's multiple taxation argument, concluding that there was a failure of proof. We do not understand that this decision in any way altered the established multiple taxation doctrine, but it does indicate that a certain threshold of proof is necessary to invoke the doctrine. In *Moorman* that proof was lacking, so it could not be determined where the income was earned in order to establish the risk of multiple taxation. *Moorman* did not deal with a situs income situation. In the present case not only is situs income the issue, but the record specifies the amount of non-Wisconsin situs income Wisconsin has attempted to tax (see Appendix I, JS App. 86). Thus, the factual proof is clearly present to show the risk and thereby invoke the multiple taxation doctrine to invalidate under the Commerce Clause the Department's application of Wis. Stats. §71.07 to Appellant's Exploration and Production functional income.

Clearly, by any test, the Wisconsin Supreme Court in this case chose to ignore the true strictures of multiple taxation as a burden on interstate commerce. This erroneous conclusion of the Wisconsin Supreme Court is further underscored, both in terms of a violation of the Commerce Clause as well as of the Due Process Clause, by its conclusion that Wisconsin is entitled to tax its "fair share" of the total corporate income of a multistate corporation regardless of the relevancy of the taxation results to the activities carried on by the multistate corporation within the State of Wisconsin.

That this is an erroneous proposition should be patently obvious. The relevant statute itself, Wis. Stats. §71.07(2), restricts Wisconsin taxation to "only on such income as is derived from business transacted and property located within the state." Thus, the incidence of taxation must be related to Appellant's activities and property in the state. The record shows little property, no exploration and production or refining, and only some expansion marketing activity in Wisconsin during the years in issue. Thus, to consider total corporate income, regardless of the type of activity and regardless of where earned, is to employ a basically incorrect concept. The Commerce and Due Process Clauses both preclude a state from taxing activities which clearly have a situs in other states. There can be no "fair share" of something a state cannot constitutionally tax.

Therefore, in utilizing a unitary *per se* approach which subjects to apportionment virtually all of Appellant's total corporate income without regard to any relationship of the activities of Appellant to Wisconsin, the Wisconsin Supreme Court sanctioned multiple taxation as an obvious and automatic end result of such a concept, and thereby placed a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution. That Appellant is disadvantaged when compared to Wisconsin intrastate operations should be obvious in that Appellant bears the risk of multiple taxation of its income.

CONCLUSION

Based upon the foregoing, it is clear that this case presents the requisite factual elements to fulfill the *Hans Rees'* and the *Moorman* prescriptions for determinations of Due Process and Commerce Clause violations. The constitutional analysis of the Wisconsin Supreme Court, by its unitary *per se* approach, is totally inconsistent with both current and historical constitutional jurisprudence. It is respectfully suggested that this Court should determine, based on the record in this case, the proper application of the Due Process Clause minimal connection (nexus) and rational relationship requirements and of the Commerce Clause multiple taxation doctrine.

Such a determination must result in this Court striking down the construction and application of the Wisconsin statutes by the Wisconsin Supreme Court as being repugnant to the Due Process and Commerce Clauses of the United States Constitution. In the process, this will also permit this Court to eliminate the split in authority existing between the present Wisconsin decision and the decisions of all other jurisdictions, state and federal, as set forth in this brief, which are wholly consistent with Appellant's position herein as regards taxation of situs operations.

It is, therefore, respectfully requested that the application of the Wisconsin statutes as construed by the Wisconsin Supreme Court be held unconstitutional, and that the decision of the Wisconsin Supreme Court be reversed, with directions that Appellant's Exploration and Production Department functional income be allocated to situs and excluded from Wisconsin apportionable income.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-509

EXXON CORPORATION,
Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal from the
Supreme Court of Wisconsin

BRIEF OF APPELLEE

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IN THE

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October Term, 1979

No. 79-509

EXXON CORPORATION,
Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the
Supreme Court of Wisconsin

BRIEF OF APPELLEE

QUESTIONS PRESENTED

1. Whether the State of Wisconsin's treatment of Exxon as a unitary business has rendered Wis. Stats. § 71.07(2) invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

2. Whether the State of Wisconsin, by subjecting income resulting from Exxon's exploration and production operations to apportionment under its formula for

taxing unitary businesses, has construed Wis. Stats. § 71.07(1) and (2) so as to render the statutes invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

3. Whether the State of Wisconsin, by subjecting income resulting from Exxon's exploration and production operations to apportionment under its formula for taxing unitary businesses, has construed Wis. Stats. § 71.07(1) and (2) so as to render the statutes invalid under the Commerce Clause of the United States Constitution.

STATEMENT OF THE CASE

A. *Proceedings Below.*

This case was commenced by Exxon when it appealed Appellee's denial of its application for abatement of an additional franchise tax assessment for the years 1965 through 1968 to the Wisconsin Tax Appeals Commission. (JS App. 81). The Tax Appeals Commission found that:

1. Appellant's three main functional operations were each separate unitary businesses;

2. Appellee's apportionment formula improperly included income from sources outside Wisconsin;

3. An apportionment formula apportioning only income earned by Appellant from its marketing function would be proper; and

4. Appellee's assessment subjected part of Appellant's income to multiple taxation. (JS App. 66).

The Appellee appealed the Commission's decision to the Circuit Court for Dane County, Wisconsin. By decision and order entered on January 31, 1977 (JS App. 34-65), that court found that Exxon was a unitary business and that its total income was subject to apportionment by Wisconsin. That court also found that all of Exxon's income from exploration and production should be excluded from apportionment as situs income and that some of Exxon's exploration and production income was being subjected to double taxation.

The circuit court decision was appealed to the Wisconsin Supreme Court on cross-appeals. Exxon appealed the unitary business issue and Appellee appealed the situs income issue.

The Wisconsin Supreme Court affirmed the circuit court's decision on the unitary business issue, and reversed the circuit court's decision on the situs income issue. (JS App. 1).

B. *Unitary Aspects Of Exxon's Corporate Structure.*

The facts in this and the preceding section are in addition to the facts presented in Exxon's brief.

Exxon's corporate-wide activities during the years at issue were coordinated by various departments under one corporate entity in order to assure a stable outlet for its products and provide for some assurance that the risk of disruptions in Exxon's refining operations was minimized under the supply and demand imbalances which occur from time to time. (A. 224-25).

Exxon's corporate structure included a segment referred to as "Coordination and Services Management"

which was responsible for providing specialized corporate services for Exxon's overall operation. This corporate segment was composed of numerous individual departments, each of which provided certain specialized services for the total corporate entity. (A. 188-89).

Thus, the corporate planning department provided long-range company planning and developed company strategies. (A. 189). The secretary's department maintained the official corporate records and was responsible for executive compensation and executive development. (A. 189).

The supply department acquired products which the marketing department sold to the public. (A. 189, 339, 344). It also had planning responsibilities involving the expansion of refineries, the determination of future supplies, the appraisal of the market conditions and the development of pricing strategies and pricing changes. (A. 297).

The treasury department was responsible for all the financial resources of the company as well as the development of company financial policy. It was also responsible for the development of plans for the appropriate financing of company activities and for supplying advice with regard to proposed investments. (A. 190). The controller's department was in charge of the company's books of account and responsible for the overall maintenance of the company's accounting systems. (A. 190). The tax department was responsible for tax administration and for providing tax advice to other departments while the law department was responsible for providing legal counsel to the various management groups. (A. 190-91, 363).

Exxon had, in addition, a public relations department for the promotion of the general public's understanding of the company's character, goals and performance (A. 191), a government relations department for the coordination of company relations with the federal government and the State of Texas (A. 191), an employee relations department responsible for providing a competent and able work force within the company (A. 191-92), a general services department responsible for providing other departments with office facilities and services (A. 192), and a medical department responsible for advising the company on employee health and providing employees with professional medical assistance and advice. (A. 192).

C. Centralized Control Over Exxon's Wisconsin Marketing Operations.

Exxon's out-of-state activities directly affected its in-state marketing operations. Thus, during the audit period, motor oils, greases and other packaged products which were manufactured by Exxon from raw materials including its own crude, were shipped into Wisconsin from the company's central warehouse facilities to be sold at retail. (A. 275, 288). Tires, batteries, and accessories were centrally purchased by Exxon's purchasing office in Houston and shipped into Wisconsin for retail sale. (A. 257-58). Gasoline sold at retail in Wisconsin during the period was obtained from another oil company through an exchange agreement negotiated and executed by the supply department in Houston. (A. 257, 349). Such exchange agreements reduce transportation costs from production point to marketing area. (A. 355-57). Additives were added by Exxon to the gasoline shipped into Wisconsin in order to assure it

complied with company-wide quality standards. (A. 355-57).

Exxon had a centralized advertising staff located in Houston which created advertising materials for use nationwide. As the company's 1965 Annual Report indicates, Exxon's "Tiger in the Tank" campaign resulted in a marked increase in retail sales. (A. 257, Exhibit 11-5 at 7 - *See* record). Exxon also employed uniform brand names and uniform packaging for its gasoline and other products. Service stations were uniformly designed and developed by the engineering staff in Houston. (A. 250). A uniform credit card system administered from Houston was used in all states. (A. 249). Finally, Exxon had a company-wide self-insurance plan which resulted in substantial savings and which covered risks up to ten million dollars. (A. 210).

The home office in Houston also developed pricing policy (A. 255), drafted uniform selling forms and contracts (A. 255), drafted product guarantees or warranties (A. 255), established sales districts (A. 255-56), located new service stations (A. 256), approved operating budgets (A. 256), invested funds and borrowed money (A. 258), approved salary increases (A. 263), and developed retirement as well as health and accident insurance plans. (A. 263-65).

SUMMARY OF ARGUMENT

I. The determination by the Wisconsin Supreme Court that Exxon's operations in Wisconsin constituted an integral part of a unitary business is amply supported by the evidence in the record. While the Wisconsin court properly held that the unitary issue presented a question of law, its decision on the unitary issue was made only after reviewing and considering a series of undisputed factual determinations. The testimony of one of Exxon's senior vice presidents demonstrated that Exxon's unity of ownership and management was directly related to the maintenance of corporate-wide profits and thereby satisfied the test formulated by this Court in *Butler Bros. v. McColgan*, 315 U.S. 501 (1942).

As a unitary business Exxon cannot through separate functional accounting attempt to impeach Wisconsin's three-factor apportionment formula, since separate accounting is incompatible with the concept of the unitary business. In addition, an extension of the separate accounting *dicta* in *Moorman Manufacturing Co. v. Blair*, 437 U.S. 267 (1978), to states which impose corporate income taxes on the basis of a three-factor formula would be in clear conflict with the *Butler Brothers* decision.

The "dependent upon or contributory to" definition of "unitary" used by the Wisconsin court is consistent with both the "unity of ownership and management" test found in *Butler Brothers* and prevailing case authority. The "necessary" test proposed by Exxon has not been accepted by this Court or any other jurisdiction. Such a test would render the unitary concept meaningless.

II. Income generated by Exxon's exploration and production activities is unitary business income and is, therefore, properly subject to apportionment under Wisconsin's three-factor formula. Exxon cannot, through separate functional accounting, prove that Wisconsin is taxing extraterritorial values. Exxon's attempt to compute divisional income by placing a value on internal transfers of crude oil is not consistent with the principle that a unitary business earns no profits until actual sales of its products are made. *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924).

In any event, Exxon's separate accounting analysis is incomplete since it fails to account for a single dollar of income on a geographical basis. Although under the unitary concept income from a unitary business cannot be rationally attributed to particular functions or precisely determined according to taxing jurisdictions, if a taxpayer is going to attempt to so attribute such income, it must account for 100% of its total net income.

Accordingly, Wisconsin is not taxing extraterritorial values in contravention of the Due Process Clause when it subjects a portion of the income generated from Exxon's exploration and production activities to apportionment; it is taxing income from a unitary business doing business in the state.

III. Exxon has failed to show the existence of any constitutionally prohibited multiple taxation. Its assertion that the Constitution prohibits even the risk or possibility of multiple taxation is not the law. In *Moorman* it was pointed out that the Commerce Clause does not prohibit some overlap in the computation of taxable income.

The record does not support Exxon's multiple taxation argument. Wisconsin has not, by including a portion of the income generated from Exxon's exploration and production operations in its apportionment formula, created any risk of multiple taxation in contravention of the Commerce Clause.

ARGUMENT

I. The Wisconsin Supreme Court's Finding That Exxon's Operations In Wisconsin Were An Integral Part Of A Unitary Business Within The Meaning Of Wis. Stats. § 71.07(2) Is Not Constitutionally Prohibited By The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

A. Only after considering the facts in the record did the Wisconsin Supreme Court determine that as a matter of law Exxon's Wisconsin operations were an integral part of a unitary business.

This Court has long recognized the concept of the unitary business. *Butler Bros. v. McColgan*, 315 U.S. 501 (1942). In concluding that California could properly treat a wholesale dry goods and general merchandise business as a unitary business the Court stated:

> At least since Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, 17 S.Ct. 305, 41 L.Ed. 683, this Court has recognized that unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis. As stated in Hans Rees' Sons, Inc., v. North Carolina, supra, 283 U.S.

> page 133, 51 S.Ct. page 389, 75 L.Ed. 879, "•••the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." (315 U.S. at 508).

The term unitary business has been variously defined. The definition relied on by the Wisconsin Supreme Court, as borrowed from the text authority of **Altman & Keesling**, *Allocations of Income In State Taxation*, (2d ed.), p. 101, is whether " 'the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state.' " (90 Wis. 2d at 711, 281 N.W.2d at 100). The test relied on by this Court in *Butler Brothers* is whether there exists a unity of ownership and management. (315 U.S. at 508).

Using either approach, the holding of the Wisconsin Supreme Court, that Exxon was a single unitary business, is amply supported by the record. The Wisconsin Supreme Court properly determined that the issue of whether Exxon's operations constituted a unitary business presented a question of law. It did not, as suggested by Appellant, determine that Exxon was inherently a unitary business. It reviewed the facts as presented in the record before the Wisconsin Tax Appeals Commission. Thus, in arriving at its determination that Exxon's business was unitary the Wisconsin court considered and relied on a series of undisputed factual determinations. (90 Wis. 2d at 714-18, 281 N.W.2d at 102-04).

The court pointed out that while Exxon's corporate organization consisted of three parts referred to as corporate management, coordination and service management, and operations management, the court was concerned only with operations management, which was the part responsible for directing the operating activities of the individual functional segments of the company.

The three major individual functional segments, or departments, of operations management were Exploration and Production, Refining, and Marketing. Each of these departments had its own management responsible for conducting the operation of the department and a separate profit center where expense and revenue were recorded to determine a profit for that department. The company considered each department a separate investment center.

Company policy required the transfer of products and raw materials between departments to be based upon competitive wholesale market prices. Inter-departmental transfers were accounted for either at posted industry prices, or at prices determined through "arm's length" negotiations between representatives from the various departments. These prices were recorded in order to determine the performance of each department.

Exxon manufactured and produced motor oils, greases, and other packaged products outside of Wisconsin, and shipped them into the state for sale. It purchased tires, batteries, and accessories through its central purchasing office, and shipped them into Wisconsin for sale.

It also transported into Wisconsin gasoline and fuel oil obtained through an exchange agreement with another oil company in order to reduce the cost of transporting gasoline and fuel oil from the source of production to the point of sale.

The Wisconsin Supreme Court pointed out that Exxon has a centrally administered credit card system used nationwide; that it promotes its products by uniform packaging and brand names; that it uses centrally designed promotional display equipment; and that its overall distribution plan is developed at its central office. It also pointed out that key employees are frequently transferred from one department to another.

The court, while indicating that Exxon had no production or refining functions in Wisconsin, stated:

> What emerges from this pattern of organization is that Humble's production and refining functions depended upon the marketing operation to provide an outlet for its products. Wisconsin was a part of Humble's marketing system. In a high capital investment industry such as the petroleum industry, the existence of a stable and assured marketing system is important for the full utilization of refining capacity. This was the testimony of a top Exxon executive who admitted that the profits of the overall corporation depend on the profits of each of the individual functional segments. (90 Wis. 2d at 718, 281 N.W.2d at 104).

The testimony the Wisconsin Supreme Court was referring to came from Oral Luper, a senior vice president of Exxon, wherein he explained why the separate corporate departments were organized under one corporate entity.

> ". . . [I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> "So, in the case of the petroleum industry . . . where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore when there are -- when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time." (90 Wis. 2d at 716, 281 N.W.2d at 103; A. 224-25).

Thus, Exxon's own witness demonstrated that unity of ownership and management is directly related to the

maintenance of corporate-wide profits and thereby supplied the very basis for the wide acceptance, for state income tax purposes, of the unitary business concept. In so doing Exxon's witness also satisfied the test formulated by this Court in *Butler Brothers*.

As pointed out in Appellee's Motion to Dismiss or Affirm, the Oregon Tax Court, in a case involving the same corporation and nearly identical facts, held that Exxon's activities in Oregon were part of a unitary business although its Oregon operations dealt almost exclusively with marketing. *Humble Oil & Refining Company v. Dept. of Revenue*, 4 OTR 284 (1971). Although Exxon suggests that evidence exists in the Wisconsin case that did not exist in the Oregon case, it appears that the essential facts relied on by the Oregon Tax Court are present in the record before the Wisconsin Tax Appeals Commission.[1]

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1 The Oregon court pointed out that:

> Humble Oil & Refining Company is a large vertically integrated corporation engaged nationwide in all phases of the petroleum industry, from discovery through production and manufacture to marketing. It has unity of ownership, operations, management, control and products; and strong centralized credit, purchasing, advertising, accounting and legal services. All segments of plaintiff's business have a great deal in common and contribute to and are dependent upon each other. The plaintiff is actually a single interrelated unitary business operation. The component parts, including those in Oregon, are too closely connected and necessary to each other to be considered as independent units.

(footnote 1 continued on next page)

The Wisconsin Supreme Court's determination that Exxon's activities in Wisconsin were an integral part of a unitary business was based on the facts in the record before it. It did not make a *per se* determination as claimed by Appellant. The Wisconsin court's determination on the unitary issue is amply supported by the facts and consistent with *Butler Brothers*. It should be affirmed by this Court.

B. *Exxon, as a unitary business, cannot through separate functional accounting prove its claim that Wisconsin is taxing extraterritorial income.*

(footnote 1 continued)

> Producing in one state and selling in another depends upon a multitude of interdependent operations, and although the petroleum Humble sold in Oregon was not its own production but that of a third party, the sales nevertheless were made possible by the company's own production. If plaintiff wasn't producing it wouldn't be selling, and what plaintiff did in Oregon was not due solely to conditions here, but was dependent upon the market elsewhere and upon plaintiff's production and manufacturing elsewhere. The marketing in Oregon was an integrated part of plaintiff's nationwide business and undoubtedly was beneficial to the corporation as a whole. It was not a completely separate, independent or local endeavor. Plaintiff's production and refining conform to the demands of the nationwide market, and the court believes plaintiff expanded into Oregon to increase demand for its products so that it could increase production and refining and thus increase profits and its stature in the industry. (4 OTR 292-93).

Separate accounting is incompatible with the concept of a single unitary business. Income from a unitary business results from the operation of that business as a single integrated unit. By its very nature that income cannot be attributed to a single activity or group of activities engaged in by such a unitary business. It must be attributed to the business as a whole.

The basic principle underlying the formula apportionment approach to the taxation of income from a unitary business was recognized by this Court in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920). In *Underwood* the State of Connecticut applied its apportionment formula to the entire net income of the taxpayer. The formula attributed 47 percent of taxpayer's taxable income, or $629,688.05, to Connecticut. Although the taxpayer attempted to show, presumably by separate accounting, that only $42,942.18 of its income was earned in Connecticut, this Court held that such showing did not support taxpayer's objection, saying:

> The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a

> method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State. (254 U.S. at 120-21).

The taxpayer in *Butler Brothers* also sought to establish by separate accounting that it suffered losses in California and, therefore, California's apportionment formula which assigned profits to that state was unreasonable and invalid. This Court held that taxpayer's separate accounting practices did not impeach the formula applied by California, stating:

> Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore. A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 121, 41 S.Ct. 45, 47, 65 L.Ed. 165, that a State in attempting

> to place upon a business extending into several States "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." Furthermore, the particular system used may not reveal the facts basic to the State's determination. Bass, Ratcliff & Gretton, Ltd., v. State Tax Commission, supra, 266 U.S. page 283, 45 S.Ct. page 84, 69 L.Ed. 282. In either aspect of the matter the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here. (315 U.S. at 507-08).

In support of its separate accounting approach Exxon relies on *dicta* from this Court's recent opinion in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), to the effect that a separate accounting analysis might have been used to show Iowa's single-factor sales formula was taxing income the source of which was extraterritorial to that state. In sustaining the Iowa tax this Court held that, "Iowa is not constitutionally prohibited from requiring taxpayers to prove that application of the single-factor formula has produced arbitrary results in a particular case." (437 U.S. at 281).

Although the *Moorman dicta* appears to support the claim that separate accounting may be used to prove that a single-factor sales formula has produced arbitrary results in a particular case, that *dicta* should not be extended to apply to the three-factor formula approach. The single-factor formula approach is inherently more suspect than the three-factor approach.[2] Iowa's single factor sales formula, by imposing a tax solely on the basis of sales, fails to recognize that income from a unitary business results from the business as a whole and not from a single factor such as sales. As this Court pointed out in *Underwood Typewriter, supra*, "[t]he profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other states." (254 U.S. at 120).[3] Clearly a single-factor formula whether based on sales or property does not consider the nature of the unitary business and could well produce a distorted result. See, *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931). The single-factor sales formula is, in addition, totally out of harmony with the three-factor formula approach adopted nearly unanimously by other States which impose corporate income taxes.[4]

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2 Justice Blackman in his dissent in *Moorman* referred to single-factor formulas as "relics of the early days of state income taxation." (437 U.S. at 282).

3 It should be noted that the taxpayer in *Moorman* attempted to compute its tax based on a three-factor formula; however, this approach was rejected by Iowa's Director of Revenue. (437 U.S. at 270-71).

4 Justice Powell's dissent in *Moorman* points out that 44 of the 45 other states which impose corporate income taxes use a three-factor formula approach. (437 U.S. at 283).

The rationale for allowing a single-factor sales formula to be impeached by a separate accounting analysis does not apply to the three-factor formula approach. The three-factor formula does recognize that income from a unitary business results from the business as a whole and not from its parts.[5] Separate accounting is conceptually incompatible with the three-factor formula approach to taxation of income from a unitary business and cannot, as indicated by this Court in *Butler Brothers*, be used to impeach the validity of such a formula. While separate functional accounting may be useful as business aid,[6] it is, as pointed out by the Wisconsin Supreme Court, "incompatible with the

> 'very essence of formulary apportionment, namely, that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps.

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5 As stated in Parts II and III of this brief, Exxon's separate accounting analysis does not account for any of its income on a geographical basis. It is submitted that a valid separate accounting analysis must account for 100% of a taxpayer's income both on a functional and a geographical basis or it is an incomplete analysis.

6 Mr. Ernest L. Wehner, a CPA with the firm of Arthur Anderson & Company and one of Exxon's witnesses, testified that it was his experience that all companies use a form of functional profitability independence accounting to measure the performance of their personnel and investment. (A. 436-37). Thus, if Exxon is permitted to impeach Wisconsin's or any other state's three-factor formula through separate functional accounting all unitary businesses will presumably be able to do likewise.

It is for that reason that the States have resorted to formulary apportionment--unrefined and approximate though the results may be--in the case of an enterprise engaged in manufacturing and selling, where the activities take place in more than one State. Essentially, the same inherent difficulties are present in seeking to divide the profits of an oil company, where producing, manufacturing and marketing take place in different States." Hellerstein, *State And Local Taxation*, (3rd Edition, 1969), p. 400.' (90 Wis. 2d at 726, 281 N.W. 2d at 109).

An extension of the separate accounting *dicta* in *Moorman* to states which impose corporate income taxes on the basis of a three-factor formula would be in clear conflict with the *Butler Brothers* decision and irreconcilable with the unitary business concept.

C. *The Wisconsin Supreme Court's determination that a business is "unitary" if its operations within the state are "dependent upon or contributory to" its operations outside the state is consistent with Butler Brothers and prevailing case authority.*

The Wisconsin court relied on the "dependent upon or contributory to" definition of "unitary" from the text authority of Altman & Keesling, *Allocation Of*

Income In State Taxation, (2d ed.), p. 101. This definition is equivalent to the unity of ownership and management test found in the *Butler Brothers* decision. Hence, in a recent case involving the same taxpayer, *Exxon Corp. v. South Carlolina Tax Com'n*, 258 S.E. 2d 93 (S.C. 1979), the South Carolina Supreme Court stated:

> The "unities" concept and the "contribution-dependence" test are by no means mutually exclusive. In the decision cited above, the courts have often applied both definitions in deciding whether or not a business is unitary in nature. The origins of both definitions may be traced to the *Butler Brothers* decision and the activities of a corporation which exhibit unity of ownership, management and operation have usually been found to be activities which are contributory or dependent upon one another. (258 S.E.2d at 95).

The South Carolina court specifically rejected the "necessary and essential" test proposed by Exxon as not in conformity with *Butler Brothers*. The court suggested that the contribution-dependence test as well as the unity of ownership and management test would become irrelevant if such a test were adopted.

The California Supreme Court has also rejected the "necessary and essential" test in favor of the contribution-dependence test. *Superior Oil Company v. Franchise Tax Board*, 60 Cal. 2d 406, 386 P.2d 33 (1963); *Edison California Stores v. McColgan*, 30 Cal.2d 472, 183 P.2d

16 (1947). Other jurisdictions have done the same. *Zale-Salem, Inc. v. State Tax Commission*, 237 Or. 261, 391 P.2d 601 (1964); *Crawford Mfg. Co. v. State Commission of Rev. & Tax*, 180 Kan. 352, 304 P.2d 504 (1956).

It is not surprising that Exxon has cited no authority for its proposal that a state should be able to apportion corporate income only when a taxpayer's in-state activity is "necessary" to one or more of the taxpayer's out-of-state functional operations. Such a "necessary" test is clearly not consistent with the *Butler Brothers* decision. The taxpayer in *Butler Brothers* maintained that its wholesale distributing house in California had no effect on its ability through centralized purchasing to obtain more favorable prices for its wholesale merchandise since it would be able to obtain the same favorable prices without the California wholesale house. This Court pointed out that there was no justification for singling out the California operation over any other and concluding that it made no "contribution" to taxpayer's total savings, saying:

> As aptly stated by the Supreme Court of California, "If the omission of the California sales would have no effect on the purchasing power, the omission of sales in an equal amount wherever made would likewise have no effect on the company's ability to purchase at a saving. Thus, by proceeding in turn from state to state, it could be shown that none of the sales in any of the states should be credited with the income resulting from the purchasing of goods in large quantities." (315 U.S. at 508-09).

Thus, this Court relied on a "contribution" rather than a "necessary" test when it recognized that while Butler Brothers' California operation may not have been necessary to taxpayer's total operation it clearly contributed to the same.

A test based on necessity would enable large multi-state corporations to argue, through a process of elimination similar to that employed by Butler Brothers, that none of its parts are necessary to the whole. Such a test would render the "unitary" concept meaningless.[7] The "necessary" test proposed by Exxon has not been adopted by this Court or any other jurisdiction. The "contribution-dependence" test adopted by the Wisconsin Supreme Court is in conformity with the *Butler Brothers* decision and with prevailing case authority.

II. Subjecting Income From Exxon's Exploration And Production Operations To Apportionment Does Not Violate The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

A. Wisconsin's treating a portion of Exxon's exploration and production income as income from a unitary business and subjecting that income to apportionment was proper.

In applying its apportionment formula to Exxon, the Appellee excluded from apportionable income any

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7 Thus, one can remove the links from a chain until there are but two left and still have a chain. Although each link contributes to the chain, only when two remain does any link become necessary.

income resulting from sales of crude oil to third parties at the well head. Appellee included in Exxon's apportionable income any income resulting from oil produced by Exxon and transferred by it to its refining operations.[8] Such apportionment was made pursuant to Wis. Stats. (1967) § 71.07(1) and (2), which provides, in pertinent part, as follows:

> (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived. . . .
>
> (2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient . . . .

8 The allocation was made by applying a so-called "barrel formula" to separate the crude oil sold to third parties at the well head from that transferred by Exxon to its refining operations. In view of the information available, the "barrel formula" was a reasonable method by which fungible, commingled goods could be separated. (A. 521). Exxon has not proposed an alternate formula or suggested that the "barrel formula" reached income which Wisconsin did not intend to tax.

Exxon contends that any income it has allocated under its separate accounting analysis to its exploration and production activities is situs income which is not subject to taxation under Wisconsin's three-factor formula. The Wisconsin Supreme Court, however, held otherwise saying that since Exxon was unitary the statute required apportionment of its business income. The court pointed out that crude oil produced by Exxon and transferred by it to its refining operations was part of the unitary stream of income and was, therefore, pursuant to Wis. Stats. § 71.07(1), properly apportionable. (90 Wis. 2d at 724). While Exxon appears to take issue with the construction given the statute by the Wisconsin Supreme Court, this Court has held that it will not interfere with a construction given a state statute by that state's highest court. *Gurley v. Rhoden*, 421 U.S. 200, 208 (1975).

Exxon further contends that the Wisconsin Supreme Court has rendered Wis. Stats. § 71.07(1) and (2), unconstitutional under the Due Process Clause because by its construction of the statutes it has taxed income resulting from Exxon's exploration and production activities which, according to Exxon, has "no rational relationship" to the State of Wisconsin.

The Appellee submits that income generated by Exxon's exploration and production activities is unitary business income and, as such, is properly subject to apportionment under Wisconsin's three-factor formula. The nexus requirement of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), and *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), is satisfied by Exxon's extensive marketing activities in the state during the period in question. The *National Bellas Hess* and *Northwestern States* cases require only that the taxing state establish some minimum connection between it and the corporate entity. This Wisconsin has done.

Exxon claims that Wisconsin is guilty of "overreach" because it includes as apportionable unitary income a portion of the income which Exxon, through its separate accounting analysis, has attributed to exploration and production activities. Again, Exxon's separate accounting analysis is inconsistent with the unitary concept. Wisconsin's three-factor apportionment formula taxes unitary business income which results from Exxon's total operation beginning with exploration and production activities and ending in sales.

Exxon's separate functional accounting does not establish that Wisconsin is taxing extraterritorial values in violation of the Due Process Clause. Income generated from

Exxon's exploration and production activities is income from a unitary business. Thus, in *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924), this Court held that a manufacturing and sales corporation was a unitary business and earned no profits prior to the actual sale of its products,[9] saying:

> So in the present case we are of opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions, beginning with the manufacture in England and ending in sales in New York and other places,--the process of manufacturing resulting in no profits until it ends in sales,--the state was justified in attributing to New York a just proportion of the profits earned by the company from such unitary business. (266 U.S. at 282).

The fact that Exxon, in order to compute divisional income, places a value on internal transfers of crude oil from its production to refining departments does not mean that Exxon has derived income as a result of such transfers. For income tax purposes Exxon has sold nothing; it has neither realized nor derived any income. It has merely made

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9 Exxon suggests that its operation is different from a manufacturing and sales business since oil and gas exploration and production activities are uniquely associated with a particular state. The Appellee submits that such a distinction is without merit. A manufacturing and sales business manufactures a product for its sales operation; Exxon extracts and refines oil for the same purpose.

an accounting adjustment to account for an internal transfer of goods.[10]

The South Carolina Supreme Court, in *Exxon Corp., supra*, rejected Exxon's claim that the income of its exploration and production departments could be computed on the basis of transfer prices rather than on actual sales to third parties. The court held that a unitary business earned no profits until actual sales of its products were made, *citing Bass, Ratcliff* and a case from the Georgia Court of Appeals. *Phillips v. Sinclair Refining Co.*, 76 Ga. App. 34, 44 S.E.2d 671 (1947).

Exxon suggests that the Wisconsin Supreme Court did not follow its own decisions in two earlier cases when it permitted Appellee to apportion income resulting from oil produced by Exxon and transferred by it to its refining operations. *Standard Oil Co. v. Wisconsin Tax Comm.*, 197 Wis. 630, 223 N.W. 85 (1929); *Kansas City Star Co. v. Department of Taxation*, 8 Wis. 2d 441, 99 N.W.2d 718 (1959).

The *Standard Oil* case was effectively reversed by a 1949 amendment to the Wisconsin statutes wherein the Wisconsin Legislature specifically rejected the separate accounting approach as a method of apportioning the income of a unitary business. *See Celon Co. v. Department of Taxation*, 269 Wis. 372, 376-77, 69 N.W. 453 (1955), wherein the Wisconsin court, referring to a report of the Wisconsin Legislative Council, explained the effect of that amendment.

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10 As indicated in footnote 6, such an accounting procedure, referred to as functional profitability independence, is used by nearly all unitary businesses. It is obviously a valid and valuable accounting tool, but it does not result in the creation of income (or loss) without a sale.

The *Kansas City Star* case did not involve the issue of separate accounting versus apportionment as the parties had previously agreed that separate accounting was the method to be used. The unitary business theory incorporated into Wis. Stats. § 71.07 (2) by the 1949 amendment was not invoked because the bulk of the tax assessed related to income years which preceded such amendment.

The Wisconsin Supreme Court in deciding the *Exxon* case recognized that under formula apportionment there is no necessity for readjusting price and other relationships among divisions within a single unitary corporation. As Mr. Keesling pointed out in his testimony before the Wisconsin Tax Appeals Commission, "I am of the opinion that in the case of a unitary business the prices at which goods transfer from one division to another is irrelevant." (A. 585).

The Appellee submits that while its formulary apportionment approach to Exxon's business does not necessarily identify the precise geographical source of income, it is a reasonable, if not the best possible, method of apportioning income from a unitary business.[11] Wisconsin is not taxing extraterritorial values when it subjects a portion of Exxon's exploration and production income to apportionment; it is taxing income from a unitary business doing business in the state. Such income has a clear and "rational relationship" to Wisconsin.

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11 "This Court in *Moorman* rejected the claim that the Constitution invalidates an apportionment formula whenever the formula might result in taxation of some income which did not have its source in the taxing state. The Court recognized the imprecision of a formulary approach but stated: 'Yet despite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula.' " (437 U.S. at 273).

B. The separate accounting analysis employed by Exxon does not support the claim that Wisconsin has taxed income with no rational relationship to the state or that it has taxed "a percentage of income out of all appropriate proportion" to the business transacted by Exxon in Wisconsin.

The Appellee contends that separate accounting is incompatible with the concept of the unitary business and cannot, under the *Moorman* decision or any other decision of this Court, be used to impeach the results of Wisconsin's three-factor apportionment formula. (*See*, Part I, B of this brief). However, even if we assume that separate accounting may be used to impeach Wisconsin's formula, Exxon's separate accounting analysis does not prove that Wisconsin has extended its taxing power beyond constitutional limitations. That analysis does not supply the proof which Exxon suggests was lacking in *Moorman*,[12] *Butler Brothers, and Bass, Ratcliff*.

Exxon's separate accounting analysis is incomplete. It fails to account for a single dollar of income on a geographical basis. Thus, for each of the years in question, although Exxon shows a loss in Wisconsin, it fails to show in which jurisdiction or jurisdictions any of its hundreds of million dollars of annual income belongs. Obviously Exxon cannot have a loss in every state. The equation is incomplete since the parts do not equal the whole.

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12 It is interesting to note that under the Iowa single-factor sales formula which was sustained in *Moorman*, the State of Wisconsin's tax during the period at issue would be almost doubled. (Exhibit 35, A. 799).

The unitary concept grew out of the realization that income from a unitary business could not be rationally attributed to particular functions or precisely determined according to taxing jurisdictions. The income from such a business could only be attributed to the business as a whole and not to its various parts. If Exxon is to prove otherwise, it cannot do so by separately accounting only for the State of Wisconsin.[13] If Exxon wants to attempt to separately account for its income on such a basis, it must account for 100 per cent of its income. Wisconsin and other taxing jurisdictions cannot be expected to rebut the piecemeal approach used by Exxon in this case.

III. Subjecting Income From Exxon's Exploration And Production Operations To Apportionment Does Not Violate The Commerce Clause Of Article One Of The United States Constitution.

The taxation by Wisconsin of income generated from Exxon's exploration and production activities does not contravene the Commerce Clause. Exxon cannot show that the tax discriminates against interstate commerce or that it creates an undue burden on such commerce. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). As pointed out by the Wisconsin Supreme Court, Wisconsin can hardly be accused of reaching beyond the limits of constitutional mandates in view of the fact that Wisconsin's assessment of taxable income for the period in question represented only 22/100 of one percent of total company income, and for the same period Wisconsin sales constituted only 41/100 of one percent of total company sales. (90 Wis. 2d at 729, 281 N.W.2d at 110).

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13 This is exactly what the Appellant attempted to do for the tax years in question. (Exhibits 11-7A-11-7D, A. 636-719).

Exxon's Commerce Clause argument is based solely on its assertion that the Constitution prohibits even the risk or possibility of multiple taxation.[14] This Court has not applied such a standard. Thus, in *Moorman* it was pointed out that the Commerce Clause does not prohibit some overlap in the computation of taxable income. After stressing the fact that the Iowa taxpayer had not established the essential factual predicate for a claim of duplicative taxation since on the record its existence was merely "speculative," this Court stated:

> The only conceivable constitutional basis for invalidating the Iowa statute would be that the Commerce Clause prohibits any overlap in the computation of taxable income by the States. If the Constitution were read to mandate such precision in interstate taxation, the consequences would extend far beyond this particular case. For some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income. Accepting appellant's view of the Constitution, therefore, would require extensive judicial lawmaking. Its logic is not limited to a prohibition on use of a single-factor apportionment formula. The asserted constitutional flaw in

14 Exxon does not claim to have shown that actual multiple taxation exists. The Wisconsin court, quoting from *Moorman*, indicated that there was no evidence in the record that Exxon was taxed on more than 100% of its total net income. (90 Wis. 2d at 729, 281 N.W.2d at 110).

> that formula is that it is different from that presently employed by a majority of States and that difference creates a risk of duplicative taxation. But a host of other division-of-income problems create precisely the same risk and would similarly rise to constitutional proportions. (437 U.S. at 278).

The Court stated further: "Finally, it would be an exercise in formalism to declare appellant's income tax assessment unconstitutional based on speculative concerns with multiple taxation." (47 U.S. at 280).

In *First Federal S. & L. v. Mass. Tax Comm'n*, 437 U.S. 255 (1978), handed down the same day as *Moorman*, the taxpayer's multiple risk argument was disposed of in a footnote:

> The federal associations also argue that the state statute violates the Commerce Clause by creating a risk of multiple taxation. They claim that some neighboring State may at some time in the future attempt to tax the income from loans secured by property in that State. This argument is wholly speculative and unsupported by evidence in the record. (437 U.S. at 262).

In both *General Motors Corp. v. Washington*, 377 U.S. 436 (1964), and *Standard Pressed Steel Co. v. Dept. of Revenue of Washington*, 419 U.S. 560 (1975), the Court declined to find any burden of multiple taxation absent an actual showing. As pointed out in the *General*

Motors decision: "[I]t has not been shown that Oregon levies any tax on appellant's activity bearing on Washington sales. In such cases we have refrained from passing on the question of 'multiple taxation.' " (377 U.S. at 449).

The record in the instant case will not sustain Exxon's multiple taxation argument. In addition, the State of Wisconsin has not, by including a portion of the income generated from Exxon's exploration and production operations in its apportionment formula, created any real risk of multiple taxation.[15] Nor will reference to exploration and production income as situs income change this result. This Court long ago in *Adams Express Company v. Ohio*, 165 U.S. 194 (1896), *reh. denied*, 166 U.S. 185 (1897), disposed of Exxon's situs claim, saying:

> In conclusion, let us say that this is eminently a practical age; that courts must recognize things as they are and as possessing a value which is accorded to them in the markets of the world, and that no finespun theories about situs should interfere to enable these large corporations, whose business is carried on through many States, to escape from bearing in each State such burden of taxation as a fair distribution of the actual value of their property among those States requires. (166 U.S. at 225).

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15 Not only is the three-factor formula designed to prevent the risk of multiple taxation, but its use by 44 of the 45 states which impose corporate income taxes should go far to eliminate the potential for such risk. (*See*, footnote 4).

Subjecting a portion of Exxon's income resulting from Exxon's exploration and production operations to apportionment as income from a unitary business does not violate the Commerce Clause.

CONCLUSION

Wherefore, the Appellee respectfully submits that this Court should affirm the decision of the Wisconsin Supreme Court.

Respectfully submitted,

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EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

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On Appeal From the Supreme Court of Wisconsin

REPLY BRIEF OF APPELLANT

This brief is submitted by Appellant, EXXON CORPORATION, in reply to the brief filed by Appellee, WISCONSIN DEPARTMENT OF REVENUE.

ARGUMENT

I. Appellant Is Contending That A Finding Of Unitary In And Of Itself Is Not Sufficient To Subject Virtually All Of its Income To The Wisconsin Apportionment Formula.

A. Neither the record here nor the principles of Due Process permit a unitary *per se* conclusion.

Although not conceding that it is a unitary business, Appellant is ready to assume, *arguendo,* that it may be unitary under some definition or other for the purposes of this case; therefore, in this Appeal, Appellant is not challenging, as its primary issue, the conclusion by the Wisconsin Supreme Court that it is a unitary business. It is, however, Appellant's position that the conclusion of unitary by the Wisconsin Supreme Court does not thereby automatically permit Wisconsin to subject virtually all of Appellant's income to apportionment under the Wisconsin statutes, particularly in light of the Commission's finding that Appellant's major functional departments constitute separate unitary businesses (JS App. 39).

Appellee asserts (at p. 11 of its brief) that the Wisconsin Supreme Court reviewed facts in the record to reach its unitary conclusion. Had it dealt with the key facts that court would have had to explain and overrule the unrefuted findings of fact that there was no economic dependence between Appellant's Wisconsin marketing activities and its Exporation and Production or Refining functions (findings of fact nos. 21 and 23, JS App. 39). Since there was *no* evidence on which to overrule these factual findings, Appellee having offered no such evidence, that

court reasoned that the unitary issue was a question of law, thus allowing it to reach its unitary *per se* result.

Both Appellee and the Wisconsin Supreme Court conclude that the existence of common ownership and some central corporate services under a single board of directors makes the entire corporate enterprise unitary, ignoring the separately managed functional departments which were proven to have operated under the principle of functional profitability independence. That court noted the obvious, that the profits of each functional segment combined to produce the profit of the overall corporation (JS App. 16). With such reasoning no corporate enterprise could ever be deemed other than unitary, regardless of how diverse and unrelated its activities.

Wisconsin's unitary *per se* concept disclosed above ignores the Due Process Clause requirements of a minimal connection between the activities taxed and the taxing state, and a rationale relationship to values connected with the state. *Moorman Manufacturing Co.* v. *Bair,* 437 U.S. 267, 272-73 (1978). Clearly, this minimal connection and rationale relationship must be viewed on an activity by activity basis, and a connection to one activity in one state does not *per se* mean all different activities in other states are subject to taxation in the first state. The principle was well stated in *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123 (1931), that Due Process is violated if the apportionment formula:

> ". . . operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction." (283 U.S. at 134).

In that case this Court concluded that the percentage of income attributable to North Carolina was "out of all appropriate proportion to the business transacted" by the taxpayer in that state. (283 U.S. at 135).

If the Wisconsin Supreme Court's sequential conclusions, one, that single ownership and overall management were all that is required for a finding of a single unitary business, and, two, that the total income of all unitary businesses is subject to apportionment, are accepted, then every corporate enterprise constitutes *per se* a single unitary business and all are *per se* subject to total apportionment. Obviously, this logic cannot pass enlightened constitutional muster, and the Wisconsin Supreme Court, in its zeal in concluding that Appellant was a single unitary business, overlooked these essential Due Process Clause requirements.

B. Proof of taxation of extraterritorial income by separate functional accounting is precisely what the Court prescribed in *Moorman*

Appellee states that separate accounting is incompatible with the concept of a single unitary business and thus argues that, by its very nature, income cannot be attributed to a single activity or group of activities engaged in by that unitary business. Appellee gives no authority for this novel proposition and ignores authority to the contrary. Various cases, including *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271 (1924); *Hans Rees' Sons* v. *North Carolina, supra; Butler Brothers* v. *McColgan,* 315 U.S. 501 (1942); and *Moorman Manufacturing Co.* v. *Bair, supra,* have all only ruled that a taxpayer attacking a formula of apportionment has the burden of proving by "clear and cogent evidence" that the formula results in the taxation of extraterritorial income. Appellee, however, seeks to stretch these decisions into the proposition that if a business is once found to be unitary, such a burden can *never* be met by the taxpayer, since, if the taxpayer is unitary, *ipso facto* all of its income is automatically subject to apportionment.

Appellee thereby is endorsing the unitary *per se* concept adopted by the Wisconsin Supreme Court which, as Appellant has set forth in its initial brief, results in a violation of the Due Process Clause of the Fourteenth Amendment to the United States Constitution. Moreover, Appellee overlooks the fact that Appellant is not attacking apportionment as being invalid when appropriately applied, but is simply arguing that Appellant's separate functional accounting fulfills the burden of proof imposed upon and permitted by previous decisions of this Court.

Nor can Appellee find solace in *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113 (1920), for there the taxpayer attempted by geographical separate accounting to show that the formula taxed income beyond the constitutional reach of the State of Connecticut, but made no further showing that the formula was either arbitrary or unreasonable in its application. In *Underwood,* the taxpayer simply took Connecticut sales and subtracted the manufacturing costs associated therewith to determine its measure of net income attributable to Connecticut. What Appellant has done, through its separate functional accounting for Exploration and Production income based on bona fide market place posted field prices, was prove that such income was derived and earned fully at the well head in various production states outside of Wisconsin and therefore had no relationship to Wisconsin and was truly extraterritorial in nature. On this basis, *Underwood* is clearly distinguishable.

Butler Brothers, supra, in that it concerned separate geographical accounting by the taxpayer which failed to show the precise sources of net income and the factors responsible for income being earned in other states, is also distinguishable from this case presently before this Court. Most importantly, *Butler Brothers* specifically

acknowledged that a taxpayer can attack a formula of apportionment by showing that it results in the taxation of extraterritorial income, although the taxpayer has the burden of proving that extraterritorial income has in fact been taxed. Appellant contends that the record here shows that this burden has been met. Finding of fact no. 18 (JS App. 39) states that the income derived from each of Appellant's functional operating departments could be determined from Appellant's books and records. The net income of the Exploration and Production Department for the years in issue is set forth in the record. Note that Appellee did not challenge finding no. 18 on appeal (JS App. 41), thus accepting the integrity of the separate functional accounting. Note further that no Exploration and Production activities were conducted in Wisconsin (see Exhibit 21, A. 756).

Notwithstanding that Appellee has here conceded the integrity of Appellant's separate functional accounting, Appellee argues that a taxpayer can never satisfy this burden of proof in that any accounting figures put forward by a taxpayer are not reliable and not compatible with the unitary concept, intimating that only the apportionment tax accounting method is reliable. Clearly, this Court never meant to make the burden of proof insurmountable for a taxpayer able to establish by other methods the unconstitutionality of a formula of apportionment that taxes extraterritorial income.

Appellant has indeed relied upon certain language in this Court's *Moorman* opinion, but, Appellant does not accept Appellee's assertion that the language contained therein is *dicta;* rather it establishes, as expressed in Appellant's initial brief, a framework necessary for a taxpayer to establish a Due Process violation when challenging a state's apportionment formula. Appellee attempts

to discredit this language in *Moorman* with the analysis that the single-factor formula in *Moorman* was inherently more suspect and, therefore, any taxpayer attempting to attack such a formula would be entitled to use separate functional accounting. This Court, in *Moorman,* made no such distinction. Thus, Appellee sets up a strawman just to indulge in its destruction; but an analysis of this Court's opinion in *Moorman* discloses no such strawman distinction.

In *Moorman,* this Court merely affirmed that it is up to the taxpayer to demonstrate that any apportionment formula, single-factor, three-factor or other, is arbitrary, unreasonable and taxes extraterritorial income; and that separate functional accounting is an acceptable means of making this demonstration. Appellee has attempted to distinguish *Moorman* on grounds not contained in that decision, namely, by the alleged difference between a three-factor formula and a single-factor formula. This Court, in *Moorman,* did not recognize that two different types of apportionment formulas would have to be attacked differently by taxpayers, depending upon whether they were confronted with a single-factor or a three-factor formula. Regardless of the type of apportionment formula involved, it is clear from *Moorman* and from earlier cases that the burden and rights of a taxpayer attacking these formulas remain the same. In this regard *Moorman* and *Butler Brothers* are still consistent and reconcilable with each other.

Consequently, if a taxpayer can prove that certain income is earned in another state, and hence extraterritorial as to the taxing state, the constitutional protection provided under the Due Process Clause is still applicable, regardless of whether a single-factor, three-factor or other formula is being utilized by the taxing state.

In the record before the trial court in this case, Appellant proved that all of its Exploration and Production functional income, included by Wisconsin in apportionable income, was, in fact, generated by operations in states other than Wisconsin. This proof consisted of not only Appellant's separate functional accounting for its Exploration and Production Department (Schedule A of Exhibit 28, A. 760), but also of testimony from various witnesses that the posted field price was a bona fide third party market price (A. 301-304, 430), and that all dispositions of crude oil by Appellant's Exploration and Production Department were made at the posted field price, whether the disposition was a sale to a third party or an internal transfer to one of Appellant's refineries (A. 204-207, 299-300). As such, Appellant has met its burden of proof as required by *Bass, Ratcliff, Hans Rees', Butler Brothers* and *Moorman, supra,* which is further supported by Appellee's concession of the integrity of Appellant's separate functional accounting.

C. The dependence-contribution test is insufficient to determine whether Due Process requirements have been met.

In its initial brief, Appellant's challenge of the "dependent upon or contributory to" test was not primarily intended to bring into question whether it was the proper definitional test of a unitary business; rather this test was challenged as a proper Due Process test to justify the taxation of Appellant's Exploration and Production income which otherwise had no rational relationship to the State of Wisconsin. The State of Wisconsin cannot rely upon the "dependent upon or contributory to" test to buttress its unitary *per se* approach and subject Appellant's total corporate income to taxation once the determination had been made by Wisconsin that Appellant was in fact unitary. As expressed above, this *per se* concept would prevent Appellant from exercising its right to prove that the apportionment formula applied by Wisconsin resulted in the taxation of extraterritorial income.

In *Hans Rees', supra,* this Court found that the Due Process Clause had been violated because the taxpayer had been able to present clear proof that extraterritorial income had been subjected to taxation by the application of an apportionment formula. By including a portion of Appellant's Exploration and Production income in Wisconsin's apportioned income, in spite of Appellant's proof and Appellee's concession that all such income was earned outside Wisconsin, the result reached by the Wisconsin Supreme Court has likewise violated the Due Process Clause of the Fourteenth Amendment to the United States Constitution. If Appellant's record here does not adequately show Appellee's overreach, then it is submitted that such a showing is judicially impossible.

II. The Subjection Of Appellant's Income From Exploration and Production Operations To The Wisconsin Apportionment Formula Does Violate The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

A. Appellant has proved, and Appellee has conceded, that its Exploration and Production net income was derived wholly outside the State of Wisconsin.

Appellee attempts to rely upon the unitary *per se* concept expressed by the Wisconsin Supreme Court to counter Appellant's constitutional Due Process argument. Appellee takes the position that since Appellant is a unitary busi-

ness all its income, including that generated by its Exploration and Production activities except for third party sales, is properly subject to apportionment under Wisconsin's three-factor formula. As discussed above, this unitary *per se* concept completely disregards the right of a taxpayer to prove that the inclusion of income in the apportionment formula is arbitrary, unreasonable and results in the taxation of extraterritorial income.

Appellee contends that just because Appellant "places a value on internal transfers of crude oil" (Appellee's brief at p. 29) does not indicate it has derived income from such transfers. This argument attempts to obscure the previously noted fact that Appellee has conceded the integrity of the income figures in the record derived by Appellant's Exploration and Production Department.

Appellee seems to have forgotten that the proof in the case below conclusively established that the internal transfer prices were identical to prices occurring in the market place for the actual sale of crude oil, of similar grade and from the same production field, to third parties, and that this proof by Appellant established that there was in fact derived income for all the activities of its Exploration and Production Department. (Confirmed by finding of fact no. 10, unchallenged by Appellee. JS App. 38.) The fact that in some of these transactions Appellant did not make a third party sale and did not realize a profit is not fatal. Appellee itself clearly recognized this in *Kansas City Star Co.* v. *Department of Taxation,* 8 Wis.2d 441, 99 N.W.2d 718 (1959).

As was set forth in Appellant's initial brief, it has never heretofore been necessary for taxpayers to be able to rely only on actual realized profits to establish that extraterritorial values or income had been taxed by an unconstitutional apportionment formula. What is important here is

that the income from the Exploration and Production activities of Appellant had been calculated by utilizing the posted field price which was recognized as a bona fide third party price that was not subject to being contrived, rigged or manipulated by Appellant. In fact, Appellee has recognized the validity and integrity of the posted field price (see Exhibit 11-11, A. 720) which is Appellee's guide to auditing oil companies), as well as the integrity of Appellant's income derived from its Exploration and Production Department (finding of fact no. 18, JS App. 39, not challenged on appeal, JS App. 41).

The decision by the Supreme Court of South Carolina rendered in *Exxon Corporation* v. *South Carolina Tax Commission,* 258 S.E.2d 93 (S.C. 1979), cannot be cited as final binding authority as that case, involving a very similar factual setting and similar questions of law, has been appealed to this Court as Docket No. 79-843, and is, as of the date of the printing of this brief, awaiting a decision on the noting of probable jurisdiction.

Appellant cited in its initial brief the cases of *Standard Oil Co.* v. *Wisconsin Tax Commission,* 197 Wis. 630, 223 N.W. 85 (1929), and *Kansas City Star Co.* v. *Department of Taxation, supra,* for the propositions, respectively, that derived income can be calculated without the necessity of third-party sales and that intercompany transfer prices can be used to determine derived income. The reasoning in these decisions on these points remains unrefuted and unchanged by the 1949 statutory amendment which the Appellee claims effectively reversed the *Standard Oil* case, or by the fact that Appellee in the *Kansas City Star* case did not challenge the use of separate accounting. *Celon Co.* v. *Department of Taxation,* 269 Wis. 372, 69 N.W.2d 453 (1955), relied upon by Appellee, acknowledged that the 1949 amendments would have no application to a "dual or multiform business", that is, one which standing alone

could operate and produce a profit, such as Appellant's Exploration and Production function. (269 Wis. at 379). Thus, whatever may have been intended by the Wisconsin Legislature, the Wisconsin Supreme Court in *Celon Co.* was careful to circumscribe the 1949 amendments relied upon by Appellee to prevent the unconstitutional result later adopted by that Court in the instant case. With respect to *Kansas City Star,* Appellee suggests that it would have applied the 1949 amendments if later years had been at issue in that case. However, the same taxpayer has continued to report in Wisconsin on a separate accounting basis using arms-length transfer prices, and indeed, has been allowed deductions for intracompany interest in such separate accounting determinations. See *The Kansas City Star Co.* v. *Wis. Dept. of Revenue,* CCH Wisconsin Tax Reports ¶201-504 (Wis. Tax Appeals Comm., 1978), *aff'd.* CCH Wisconsin Tax Reports ¶201-591, (Cir. Ct. Dane County, 1979).

Appellee admits (at page 31 of its brief) that its formula apportionment approach does not necessarily identify the precise geographical source of Appellant's income, but contends that it is a reasonable, if not the best possible, method of apportioning the income of a unitary business. However, Appellant's proof, the unchallenged separate functional accounting of its Exploration and Production Department, coupled with its use of a bona fide market price, the posted field price, has enabled Appellant to specifically identify the geographical source of its Exploration and Production income as being all outside of and therefore extraterritorial to the State of Wisconsin. That proof cannot be ignored, as Appellee suggests, on the basis that it is not compatible with the unitary concept. Nor can Wisconsin overcome this proof by adopting the unitary *per se* approach and contending that merely because Appellant is unitary all of its income, regardless of its source, is subject to apportionment by Wisconsin.

B. Appellant's separate functional accounting fulfills the requirement prescribed in *Moorman* for proof of a Due Process violation.

In its *Moorman* decision, this Court found against the taxpayer for lack of adequate proof by "separate accounting analysis" showing the taxation of extraterritorial income (437 U.S. at 272). The prescription, therefore, to establish a Due Process Clause violation is separate functional accounting proof. Such proof is clearly found in the record here.

Appellee contends that, because Appellant's separate functional accounting analysis does not account for "a single dollar of income on a geographical basis" (page 32 of its brief), such analysis is incomplete. Not only is this statement incorrect, but it begs the question since it has no bearing on the proof upon which Appellant relies to support its constitutional attack on the Wisconsin apportionment formula. Part of Appellant's record before the Commission established on a geographical accounting basis the income attributable to Wisconsin. For the years in issue, this showed significant losses. This information was put forth by Appellant, not for its proof in chief as to the unconstitutional application of the Wisconsin apportionment formula, but rather to emphasize that by any accounting standard, functional or geographic, the Exploration and Production income of Appellant was extraterritorial in nature and not subject to taxation under Wisconsin's apportionment formula. Once Appellant has proven that its Exploration and Production income is extraterritorial in nature to Wisconsin, surely it does not have to then explain on a nationwide basis what has happened to the balance of its income in order to provide validity for the proof of the extraterritorial Wisconsin overreach. Appellee overlooks the established tax law

principle that a taxpayer need only prove the assessment is arbitrary or incorrect to meet his burden of proof; he is not required to prove the correct taxable income. *Helvering* v. *Taylor,* 293 U.S. 507 (1935).

Because the Exploration and Production income is extraterritorial in nature, it remains such regardless of how the balance of Appellant's income is treated elsewhere. Appellee apparently believes that Appellant is relying primarily on its geographical separate accounting for Wisconsin to support its constitutional attack on the application of the Wisconsin apportionment formula. The record below with the proof set forth therein, and Appellant's separate *functional* accounting for its Exploration and Production Department, together with proof of the nature and usage of the posted field prices, combine to establish that its Exploration and Production income is extraterritorial in nature and not subject to taxation by the State of Wisconsin. Consequently, Appellant's proof is not piecemeal in nature, but rather is complete in establishing that such income is extraterritorial to and has no relationship with the State of Wisconsin.

III. Subjecting Income From Appellant's Exploration And Production Operations To Apportionment In Wisconsin Does Violate The Commerce Clause of Article I Of The United States Constitution.

Appellee, like the Wisconsin Supreme Court, makes the argument that, since Wisconsin's assessment of taxable income for the period in question was only 22/100ths of one percent of Appellant's total company income while for the same period Wisconsin sales constituted only 41/100ths of one percent of total company sales, Wisconsin cannot be accused of reaching beyond its constitutional limits.

This *de minimus* argument finds no support in either theory or previous decisions by this Court. The unconstitutional application of a state's apportionment formula, resulting in the taxation of extraterritorial income, is not rehabilitated simply because the amount of income being subjected to apportionment is extremely small when compared to the taxpayer's total company income. If a tax is unconstitutional, it is unconstitutional regardless of the amount of dollars involved.

Appellee cites *Moorman, supra,* as authority that Appellant's Commerce Clause argument is not valid. *Moorman* does not support this position; it stands for the proposition that, merely because a state uses a single-factor apportionment formula even though most other states use the more common three-factor apportionment formula, this alone, without special evidentiary proof, does not show a sufficient risk of multiple taxation to render the single-factor formula unconstitutional under the Commerce Clause of the United States Constitution. This Court in *Moorman* recognized that when different states use different formulas some risk of duplicative taxation exists, but not a sufficient risk of multiple taxation to cause such usage to be unconstitutional *without special proof.*

The risk of multiple taxation which Appellant claims exists in this case is not brought about by apportionment formulas with different numbers of factors; rather it is created by the inclusion in Wisconsin's apportionable income of situs or extraterritorial income earned by Appellant's Exploration and Production Department. Such income has obviously been taxed by Wisconsin and as witnessed by the cases cited in Appellant's initial brief, is taxed or exposed to taxation in those states where such Exploration and Production income is actually derived and earned. *Moorman* does not address this problem, and this

Court's decision in *First Federal Savings & Loan Association of Boston* v. *State Tax Commisison,* 437 U.S. 255 (1978), is distinguishable, as there the taxpayer argued that at some time in the future another state *might* attempt to tax income from loans secured by property in that state, but apparently no record was made by the taxpayer that such income even existed or that it was actually earned in another state.

Finally, Appellee's closing quote from this Court's decision in *Adams Express Company* v. *Ohio,* 165 U.S. 194 (1896), *rehearing denied,* 166 U.S. 185 (1897), is not dispositive of Appellant's situs income position. *Adams Express* questioned the ability of a state to impose an *ad valorem* property tax upon intangible assets of the taxpayer. These intangibles were calculated by taking the total value of the corporation, determined by multiplying the total number of shares of the corporation by the market value for such shares, and deducting therefrom the total value of the taxpayer corporation's real and personal property. In *Adams Express,* the taxpayers argued that such intangible assets only had a situs in the state where each corporation was domiciled and could not therefore be taxed by any other states. Discussing this position of the taxpayers, this Court stated:

> "Where is the situs of this intangible property? Is it simply where its home office is, where is found the central directing thought which controls the workings of the great machine, or in the state which gave it its corporate franchise; or is that intangible property distributed wherever its tangible property is located and its work is done? Clearly, as we think, the latter." (166 U.S. at 223).

Certainly, the quotation utilized by Appellee from *Adams Express* has no application to Appellant's situation where Appellant's proof established that the Exploration and Production income had been actually derived and earned from the operation of oil and gas production activities in states other than Wisconsin. Appellant's case does not involve the question of a situs determination for elusive intangible assets. Moreover, *ad valorem* taxes involve issues of valuation, wholly dissimilar to the issues of the isolation and identification of taxable income.

The reasoning set forth in Appellant's initial brief concerning the Commerce Clause violation resulting from the Wisconsin Supreme Court's application of the Wisconsin apportionment statute is valid and should be followed. The constitutional principle embodied in the multiple taxation doctrine forbids, under the Commerce Clause, overlapping taxation. As previously espoused by this Court, this doctrine deals with the power to tax rather than the actuality of taxation. The argument that there is no Commerce Clause violation without proof of the actuality of multiple taxation, if adopted, would mean an emasculation of the multiple taxation doctrine, and in effect would mean that state taxation of multistate businesses is a foot race where the first state to tax an activity wins.

Thus, the actuality of multiple taxation cannot be the proper constitutional test; rather the test must involve the power of another state to tax the activity in issue. Income derived at situs is obviously within the power of the situs state to tax. Even Wisconsin recognizes this, both in its statute which allocates to situs the income derived from any farm, mine or quarry, and by Appellee, which concedes that oil and gas production is "mining", yet excludes only situs income from third party sales from apportionable income. But this exclusion does not satisfy constitutional requirements, as all income derived from situs operations should be excluded.

The present record conclusively establishes the accounting integrity of the income derived from Appellant's Exploration and Production function. Appellant's expert accounting witness, Mr. Wehner, a premier oil and gas accounting authority, testified to the correctness of the determination of the Exploration and Production functional income based upon transfer prices equivalent to third party prices; the trial court found this as a fact; and Appellee did not dispute this. The record here stands unrefuted as to the proper measure of the income derived from the Exploration and Production function. Thus, there is *no* dispute as to the amount of the situs income; the only dispute is as to whether Wisconsin can tax it.

This Exploration and Production functional income is unquestionably situs income, and also it is without question that the states where the Exploration and Production activities are conducted have the power to tax this income. For a non-production state to include Exploration and Production income in apportionable income subjects such income to at least the risk and, as demonstrated by the cases cited in Appellant's Brief, in many instances the actuality of multiple taxation. If the Commerce Clause's multiple taxation doctrine means what this Court has previously said it means, then Wisconsin cannot include *any* income derived from Exploration and Production in apportionable income. Consequently, a reversal of the Wisconsin Supreme Court as regards the taxation of situs income is essential for compatibility with the decisions cited in Appellant's Brief.

CONCLUSION

For the reasons expressed herein and in Appellant's initial brief, it is respectfully submitted that Appellant has fulfilled the requisite burden of proof necessary to establish Due Process and Commerce Clause violations arising from the Wisconsin Supreme Court's interpretation and application of the Wisconsin apportionment statute to Appellant's Exploration and Production Department's income. It is, therefore, respectfully requested that the application of the Wisconsin statutes as construed by the Wisconsin Supreme Court be held unconstitutional, and that the decision of the Wisconsin Supreme Court be reversed, with direction that *all* income derived from Appellant's Exploration and Production Department be allocated to situs and excluded from Wisconsin apportionable income.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1979

No. 79-509

EXXON CORPORATION,

Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF WISCONSIN

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* OF ASSOCIATED DRY GOODS CORPORATION

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-509

EXXON CORPORATION,

Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* IN SUPPORT OF APPELLANT

Pursuant to Rule 42 of the Rules of the United States Supreme Court, Associated Dry Goods Corporation (hereinafter referred to as "Associated") respectfully moves for leave to file the accompanying brief in this case as *amicus curiae*. The attorneys for Exxon Corporation and the attorneys for the Wisconsin Department of Revenue have refused to consent to the filing of the accompanying brief *amicus curiae*.

Associated is a Virginia corporation which owns and operates seventeen retail department and specialty store divisions in twenty four states and the District of Columbia and is subject to taxation in all of these jurisdictions. During the last several years, Associated has contested various state administrative determinations of its state income tax liability which have been based on the finding that Associated is a "unitary" business and consequently subject to apportionment taxation.

While Associated has asserted in administrative and judicial proceedings that it is not a unitary business, it has also asserted with mixed success that the mere finding of unitariness does not, as a matter of law, support the application of an apportionment method of taxation. Although this point has been raised by Exxon Corporation in its Jurisdictional Statement to this Court, Associated believes that this issue is one with far-reaching sig-

nificance which should be more thoroughly examined and discussed.

Associated therefore submits that it has a significant interest in the case before the Court as well as experience in matters of state taxation to enable it to present a brief *amicus curiae* that will aid the Court in its deliberation.

Date: January 10, 1980

Respectfully submitted,

. . . . . .

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October Term, 1979

No. 79-509

EXXON CORPORATION,

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WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

BRIEF *AMICUS CURIAE* OF ASSOCIATED DRY GOODS CORPORATION

ARGUMENT

The Determination That an Interstate Business is Unitary Does Not, as a Matter of Law, Support the Application of a State's Apportionment Method of Taxation to That Business Without Further Inquiry.

Associated files this brief *amicus curiae* in support of the appeal of Exxon Corporation and submits that this case provides the Court with the opportunity to clarify certain concepts relating to state taxation of interstate businesses. As stated in Exxon Corporation's Jurisdictional Statement, issues of well-settled tax law and doctrine are not being reopened in this case; nevertheless, Associated respectfully submits that the concept of unitariness which has been developed by this Court in *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271, 45 S.Ct. 82 (1924), *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123, 51 S.Ct. 385 (1931), *Butler Bros.* v. *McColgan,* 315 U.S. 501, 62 S.Ct. 701 (1942) and *Moorman Manufacturing Co.* v. *Bair,* 437 U.S. 267, 98 S.Ct. 2340 (1978) has not only been inappropriately and, as a consequence, unconstitutionally applied by the

Wisconsin Department of Revenue in the case before the Court but that it has also been inappropriately applied to interstate businesses by many other state taxing authorities.

In general, over the years the concept of unitariness, as construed by these state taxing authorities, has become a convenient, simplistic formula which has been indiscriminately applied to interstate businesses without regard to the actual activities of these businesses within the taxing state. As a result many interstate businesses are unconstitutionally taxed in one state for income attributable to the taxpayer's activities in another state.

It cannot be posited that the intent of this Court or the rule of law involving the unitary concept would permit state taxing authorities, as a matter of mere rote and with total disregard of the facts, to indentify some indices of unitariness on the part of an interstate business and conclude that the business is unitary and therefore subject to taxation on an apportionment basis.

In fact, Associated suggests that a careful study of the facts which relate to this issue would reveal that state taxing authorities utilize the apportionment method primarily because of its convenience and simplicity, without regard to equity or fairness or constitutional questions, because the apportionment basis provides an easy and shorthand way in which state taxing authorities can assess tax. In other words, the state authorities can, with minimum effort, utilize the federal income tax returns and apply apportionment formulas thereto without regard to underlying functional and taxing considerations. Furthermore, in situations where businesses file returns on a separate accounting basis, this approach has enabled state taxing authorities to compute the amount of tax liability under both the apportionment and separate accounting method and then arbitrarily assess the tax based upon whichever method provides them with the greatest amount of revenue.

This arbitrary and bureaucratic method of application of apportionment formulas by state taxing authorities requires a

remedy by this Court. In rejecting the Wisconsin Department of Revenue's "unitary *per se*" approach to state taxation, the Court has an opportunity and a duty to clarify that the determination alone that a business is "unitary", without further inquiry, does not justify the application of apportionment taxation.

Indeed, determinations by state taxing authorities as to whether an interstate business is unitary for tax purposes almost seem to ignore the fact that the ultimate issue is one of taxation. Many indices of unitariness cited by state taxing authorities are totally irrelevant to tax issues. For example, in determining whether a business is unitary state taxing authorities have relied on such indices as the fact that the president of the business has the ultimate right to hire and fire personnel, that the business has a common pension plan, that officers of the divisions hold annual meetings to discuss common problems, that the divisions send regular reports to the corporate home office, and that the officers of the various divisions are also officers of the corporate entity.

However, the determination of the income tax liability of a business must relate to income and income in turn is a function of revenue and expense; consequently, the determination of the income tax liability of a multistate business must go beyond simply identifying organizational unitary characteristics and must be directed to determining the taxpayer's sources of revenues and expenses. Where the preponderance of relevant indices are not treated by the corporation on a unitary basis and where it can be shown by clear accounting systems and routine bookkeeping entries that revenue and expense arise solely within a state, the income derived therefrom is taxable. Where it can be shown that revenue and expense arise outside a state, the income derived therefrom cannot be taxable by that state and in such circumstances, separate accounting for tax purposes must be employed. On the other hand, where there is a national or interstate unity of accounts, then unitary characteristics for tax purposes are significant and the application of an apportionment method of taxation is appropriate.

Such inquiry into the nature and quality of revenue and expense is quite commonly undertaken in the regulatory domain among regulated industries and there is no reason why state taxing authorities should not be equally as sophisticated in their inquiry.

This is not to say that the inquiry concerning unitariness does not have its place, but as the Jurisdictional Statement of Exxon so aptly points out, a finding of unitariness merely presents a condition precedent to apply an apportionment method; it does not provide the conclusion or the result of the taxation inquiry. If it does, then economic realities may be ignored and the constitutional protections against a state extending its taxing power beyond its borders are relegated to a fairyland unrelated to real facts.

Consequently, Associated supports Exxon Corporation's position that this Court should reject the Wisconsin Department of Revenue's "unitary *per se*" approach to state taxation. Furthermore, Associated respectfully submits that the Court should take this opportunity to clarify the appropriate use of the unitary concept in determining whether an apportionment method of taxation may be applied to an interstate business. In this regard, it is submitted that this Court should provide language which would clearly specify that in determining the appropriateness of applying an apportionment method of taxation, state taxing authorities should go beyond the determination that a business is unitary and should inquire as to the economic realities of the taxpayer and as to tax considerations relating to the appropriate situs determination of revenue and expense.

This can be done by indicating that the unitary concept is not intended to be a simplistic formula or rubric but only one of the tools that may be used to determine the state tax liability of an interstate business. Other forms of evidence may always be adduced to determine the most appropriate and equitable method of state taxation.

Conclusion

For the reasons stated above, the Court should reject the Wisconsin Department of Revenue's unitary *per se* approach to determining the tax liability of an interstate business.

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No. 79-509

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OCTOBER TERM, 1979

EXXON CORPORATION,
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vs.
WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal From the Supreme Court Of Wisconsin

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No. 79-509

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1979

EXXON CORPORATION, *Appellant*, vs. WISCONSIN DEPARTMENT OF REVENUE, *Appellee.*	On Appeal From the Supreme Court Of Wisconsin

BRIEF OF THE STATES OF ILLINOIS, CONNECTICUT, MASSACHUSETTS, MINNESOTA, AND VERMONT AS AMICI CURIAE

INTEREST OF THE AMICI CURIAE

Every State which imposes an income tax on corporations relies upon an apportionment formula to determine the portion of multistate corporate income which it will tax.[1] Exxon seeks to avoid the effects of the apportionment formula, as applied in Wisconsin, by offering a method of accounting for income which it has developed for its own internal management and financial purposes. If Exxon is permitted to be taxed on its alternate method of accounting, the concept of state taxation based upon formulary apportionment will be rendered devoid of meaning and effect. Corporate taxpayers will be invited to devise methods of accounting which, though based upon generally accepted principles of accounting, do not accurately reflect income for State tax purposes. State revenues will be adversely affected, the cost and complexity of auditing tax returns will be dramatically increased, and the degree of fairness and uniformity the States have achieved in the taxation of residents and corporations will be undermined.

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[1] Prentice Hall, All-States Tax Reporter, para. 223; *Moorman, infra,* (Powell dissenting) 437 at 283.

This brief is submitted on behalf of the States of Connecticut, Illinois, Massachusetts, Minnesota, and Vermont. It is filed pursuant to Rule 42(4) of the Rules of this Court, and the consent of the parties is not required.

A STATE TAX WHICH FAIRLY APPORTIONS THE INCOME OF A VERTICALLY INTEGRATED BUSINESS DOES NOT VIOLATE THE DUE PROCESS CLAUSE SIMPLY BECAUSE THE BUSINESS HAS DEVELOPED A DIFFERENT METHOD OF ACCOUNTING FOR ITS INCOME

A. INTRODUCTION

Exxon claims that the method of "separate functional accounting" employed by Humble Oil and Refining Company (Humble) accurately reflects the income earned by each of the operational functions within Humble and that a State will violate the Due Process Clause if it imposes an income tax in a manner which overlooks these separate functional operations. Exxon finds support for this claim in two arguments. First, it reads *Moorman Manufacturing Co.* v. *Bair,* 437 U.S. 267 (1978) as an acknowledgment "that separate functional accounting may be used by a taxpayer to identify the income from various phases or functions of a taxpayer's operations, and thereby establish that the income attributable to a given state is 'out of all appropriate proportion to the business transacted . . . in that state.' *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123, 135 (1931)." Appellant's Brief p. 13-14. Exxon then argues that the testimonial and documentary evidence it presented before the Wisconsin Tax Appeals Commission established the integrity of the posted price and transfer price system used to determine income by function and that this was the type of proof missing in *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271 (1924), *Butler Brothers* v. *McColgan,* 315 U.S. 501 (1942) and *Moorman, supra,* but which was present in *Hans Rees', supra.* Exxon's second

argument is essentially a disagreement with the Wisconsin Supreme Court's interpretation of what constitutes apportionable income under Wis. Stat. sec. 71.07(1) + (2) and the assertion that the Court's interpretation results in the taxation of extraterritorial activities which bear no rational relationship to the activities conducted within Wisconsin.

None of these arguments should be addressed until a most basic question is answered—what is wrong with the result reached by Wisconsin's apportionment formula? During the years in question Humble's service stations and retail outlets sold gasoline, oil, lubricants and automobile accessories. Annual sales in Wisconsin ranged from $12,980,144. in 1965 to $16,384,760. in 1968. (A.617) Humble's tangible property in Wisconsin increased from $11,233,948 in 1965 to $14,539,290. in 1968. (A.611) Humble filed tax returns claiming it did not owe any state tax for any of the years.[2] Wisconsin, after determining apportionable income and the apportionment factors, assessed Humble's tax liability as $316,471. for the four years in question. Is this result "out of all appropriate proportion to the business transacted . . . in that state," *Hans Rees', supra,* at 135, or has it "led to a grossly distorted result," *Norfolk & Western R. Co.* v. *State Tax Commission,* 390 U.S. 317, 326 (1968)?

B. RELIANCE UPON A FORMULA FOR APPORTIONING INCOME IS A FUNDAMENTAL PRINCIPLE OF STATE INCOME TAXATION.

This Court has long recognized the importance and the validity of the principle of apportionment in the imposition of state taxes. *Adams Express Co.* v. *Ohio,* 165 U.S. 194 (1896),

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[2] In its 1965-68 returns, Humble sought to avoid the apportionment of any income by accounting for profit (or loss) according to what it considered to be Wisconsin sources. Exxon now concedes, without any explanation, that the income it attributes to its nationwide marketing operations should be subject to formulary apportionment. (Appellant's Brief p. 33)

rehearing 166 U.S. 185 (1897) (an *ad valorem* property tax); *Underwood Typewriter Co.* v. *Chamberlain,* 245 U.S. 111 (1920); *Bass, Ratcliff & Gretton* v. *State Tax Commission, supra;* and *Moorman Manufacturing Co.* v. *Bair, supra* (net income tax cases); and *Flint* v. *Stone Tracy Co.,* 220 U.S. 107 (1911); *Ford Motor Co.* v. *Beauchamp,* 308 U.S. 313 (1939) (net worth or franchise tax cases). Every one of the 45 states which impose a corporate income tax rely on some type of apportionment formula to determine the amount of taxable income earned by a multistate business.[3] By far the most common formula is the 3-factor formula which compares instate to total property, payroll and sales.[4] (Wisconsin uses the cost of manufacturing instead of a payroll factor.) An apportionment formula is a method of approximation; it is not a method of item by item determination according to geographical source, type of transaction, type of income, or phase of business operation. It is a reasonable approximation because it is based upon the premise that instate income compared to total corporate income is directly proportional to instate and total property, payroll and/or sales. These factors take into account a proper spectrum of the corporate presence within and without the State. The formula is also a recognition that attempts to identify the exact source of income, whether by geography, function or whatever, ultimately lead to unrealistic assumptions, arbitrary decisions, unverifiable results, and time-consuming and expensive accounting and audit programs. A critical feature of the apportionment formula is "apportionable income"—the amount by which the average of the various factors is multiplied in order to arrive at taxable income. Although Wisconsin excluded from apportionable income Humble's income from crude oil sold to third parties and income from intangible assets (dividends, interest, capital gains, rents, etc.), most state statutes would apportion all net income from

[3] See note 1.

[4] See note 1.

Humble's petroleum business regardless of its nature or geographical source. A state which fairly apportions income is not required to yield to a state which allocates a portion of that income. *Johns-Manville Products Corp.* v. *Comm. of Rev. Adm.* 115 N.H. 428 (1975), appeal dismissed, 423 U.S. 1069 (1976).

Formulary apportionment and separate accounting (by whatever source) are fundamentally different methods of determining income for state tax purposes. The States have adopted formulary apportionment, and this Court has approved that exercise of taxing authority absent Congressional legislation. *Moorman, supra.* There must be compelling reasons to abandon full, fair apportionment. Neither increased revenues to States nor savings to taxpayers could justify the complexities, distortions and costs created by employing item-by-item allocations. Thus, several States have held that there must first be an explicit finding that full, fair apportionment does not fairly represent the extent of the taxpayers instate business activities. *St. Johnsburry Trucking Co.* v. *New Hampshire,* CCH NH State Tax Rptr, Par. 200-121 (1978); *Amoco* v. *Arnold,* 213 Kas. 636, 518 p. 2d 453 (1974); *Donald M. Drake Co.* v. *Dept. of Revenue,* 263 Ore 26, 500 P2d 1041 (1972); *Kennecot Copper Corp.* v. *State Tax Comm.,* 27 Utah 2d 119, 493 P2d 632 (1972); *Superior Oil Co.* v. *Franchise Tax Board,* 34 Cal Reptr 545, 386 P2d 33 (1963). Otherwise the State revenues will be jeopardized and the fairness of the tax system to all other taxpayers will be called into question; Exxon simply has not shown that the result reached by Wisconsin's apportionment formula is out of proportion to the business conducted in the state.

Appellant's brief (pp. 40-43) refers to State court decisions upholding direct allocation and separate accounting. Either for statutory or factual differences, or both, those cases are distinguishable, and they do not have a bearing on how Wisconsin should interpret its statute. For example, the Kansas statute involved in *Webb Resources Inc.* v. *McCoy,* 401 P.2d 879, at 885 (Kan., 1965) expressly preferred direct allocation rather

than formulary apportionment. Thus, the formula method could be used only if direct allocation was impracticable or the books did not clearly reflect income. Moreover, the statute was repealed in 1963. *Standard Oil Co. of Indiana* v. *Wisconsin,* 223 N.W. 85, at 86 (192), involved statutory provisions similary to those in this case except that the controlling phrases "not requiring apportionment under sub(2)" and "when the business of such person is not an integral part of a unitary business" did not appear in the statute at that time. None of the State cases relied upon by Exxon support its argument that the Wisconsin Supreme Court reached an unconstitutional result in the interpretation of Wisc. Stat. 71.07 (1) & (2).

C. SEPARATE FUNCTIONAL ACCOUNTING MAY BE USEFUL TO HUMBLE'S MANAGEMENT BUT IT IS UNACCEPTABLE FOR STATE TAX PURPOSES.

The evidence presented to the Tax Appeals Commission indicated that there was a corporate purpose to be served by Humble's separate functional accounting. It allowed corporate management and coordination and services management to guage the profitability of the various operations and thereby be in a better position to make decisions concerning the efficiency and investment potential of each operation. Exxon argued that if it could establish that its use of posted field prices and transfer prices conformed with generally accepted accounting principles, then it should be taxed *as if* it operated the three departments as separate businesses. Exxon's accounting by operations is a type of financial accounting as opposed to tax accounting. Two of Exxon's witnesses, Mr. Wehner and Mr. Solomon, recognized the validity of this distinction. (A. 455 and 510-11).

This Court has recently observed that financial accounting serves vastly different objectives than tax accounting, and that the former, even though it may reflect generally accepted accounting principles, does not necessarily reflect income for tax

purposes. *Thor Power Tool Co.* v. *Commissioner,* ____, U.S. ____, 99 S. Ct. 773 (1979).

> The primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and others properly interested; the major responsibility of the accountant is to protect these parties from being misled. The primary goal of the income tax system, in contrast, is the equitable collection of revenue; the major responsibility of the Internal Revenue Service is to protect the public fisc. 99 S. Ct. 786.

This was one of the reasons the Court held that Thor Power's writedown of "excess" inventory was not an allowable deduction for federal purposes even though it may have been in conformity with generally accepted accounting principles.

This Court went on to state:

> Finally, a presumptive equivalency between tax and financial accounting would create insurmountable difficulties of tax administration. Accountants long have recognized that "generally accepted accounting principles" are far from being a canonical set of rules that will ensure identical accounting treatment of identical transactions. "Generally accepted accounting principles," rather, tolerate a range of "reasonable" treatments, leaving the choice among alternatives to management. Such, indeed, is precisely the case here. Variances of this sort may be tolerable in financial reporting, but they are questionable in a tax system designed to ensure as far as possible that similarly situated taxpayers pay the same tax. *If management's election among "acceptable" options were dispositive for tax purposes, a firm, indeed, could decide unilaterally—within limits dictated only by its accountants—the tax it wished to pay.* Such unilateral decisions would not just make the Code inequitable; they would make it unenforceable. 99 S. Ct. 787. (emphasis added) (footnotes omitted)

Mr. Jeager, a manager of the Supply Department, testified that he managed the crude oil supplies of the company, including the purchase, sale, exchange or transfer to refineries

of the company's crude, and that he was involved in the development of pricing strategies. (A. 296-7) For some reason, the Supply Department is not treated as a profit center as are marketing, refining or exploration and production. This is precisely the type of "unilateral decision" which makes Humble's separate functional accounting unacceptable for state tax purposes.

Thor Power recognized that use of financial accounting for tax purposes could lead to inequitable and unenforceable tax administration. This Court has also stated that financial accounting should not be used to impeach the results of formulary apportionment:

> Accounting practices for income statements may vary considerably according to the problem at hand. (citation omitted) A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. (citation omitted) That may be due to the fact (citation omitted) that a State in attempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' Furthermore, the particular system used may not reveal the facts basic to the State's determination. (citation omitted) In either aspect of the matter the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here. ***Butler Bros.***, v. ***McColgan,*** 315 U.S. 507-8

The evidence offered by Exxon to impeach Wisconsin's method of apportionment is based solely upon its "separate functional accounting." One cannot imagine a more obvious contradiction to the unanimous decision in ***Butler Bros., supra.***

Humble's merger with Exxon raises additional doubts as to the applicability of its internal methods of accounting for state income tax purposes. At least some public officials have been given the impression that separate functional accounting does

not exist for Exxon, if not for Humble. In a letter dated December 5, 1975 from Senator Philip A. Hart, Chairman of the Antitrust and Monopoly Committee of the Senate Judiciary Committee to the Chief Executive Officer of Exxon Corporation, Sen. Hart requested "profit and loss statements and balance sheets, audited or unaudited, covering separately production, transmission, refineries and marketing." *Hearings on S. 2387 and Related Bills Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary,* 94th Cong., 1st Sess. 1811 Vol II (1975) (hereinafter cited as 1975 Hearings). In a letter dated January 6, 1976 to Senator Hart, a representative of Exxon wrote:

> " . . . Exxon Corporation's financial records are not maintained on a functional or segment basis similar to those categories set forth in your (letter dated December 5, 1975) . . . the petroleum business is unitary in nature. The most meaningful segmentation of our operations is the "upstream"/"downstream" segmentation previously furnished for the years 1972-1974. Further breakdowns require many allocations and assumptions, which could lead to erroneous comparisons of data between various companies and hence erroneous conclusions." 1975 Hearings 1817.

Although these letters relate to Exxon, not Humble, and involve the years 1972-75, instead of 1965-68, some explanation appears to be in order if only to clarify whether or not the petroleum business is unitary in nature and whether allocations and assumptions about different operations would lead to erroneous comparisons.

D. WISCONSIN'S DETERMINATION OF APPORTIONABLE INCOME DOES NOT VIOLATE THE DUE PROCESS CLAUSE

A review of the testimony before the Commission and of the facts as summarized by the Wisconsin Supreme Court and by the parties makes one wonder, if a vertically integrated oil

company is not a unitary business, what is? Every state tax statute which distinguishes between business and nonbusiness income or which makes reference to a unitary business certainly anticipates that such an entity exists. There is no doubt that within Humble there was a flow of product from one operation to another, there was a flow of funds within the organization, and there was a centralized management which, among other things, attempted to maximize corporate profits by coordinating demand and supply imbalances for each phase of operations. Neither the state of South Carolina nor Oregon had difficulty finding that Humble was a unitary business. See *Exxon Corp.* v. *South Carolina Tax Com'n,* ____ S.C. ____, 258 S.E. 2d 93 (1979) and *Humble Oil & Refining Co.* v. *Dept. of Revenue,* 4 OTR 284 (1971). The only real question is whether Wisconsin Statute sec. 71.07(1) & (2) requires the Department of Revenue to apportion all of the income of a unitary business or whether it must exclude all situs income. This is a question of State law, and the Wisconsin Supreme Court is properly the final arbiter. In a similar case of statutory construction, the Supreme Judicial Court of Maine, when asked to decide whether certain income was apportionable under its statute, stated:

> It could not have been the purpose of this legislation to create a system for rationalizing state income taxation of multistate or multinational business concerns, only to render it practically ineffective by requiring a showing that various items of out-of-state income, received in the regular course of business, were connected in some demonstrable way with activities of the taxpayer in Maine. *Albany International Corp.* v. *Halperin,* ____ Me. ____, 388 A.2d 902, 906 (1978)

Exxon's legal analysis and conclusion that Wisconsin's apportionment of all unitary income violates the Due Process Clause does not withstand close scrutiny. Exxon argues that the contribution or dependency test should be rejected.[5]

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[5] The test was originally used to define a unitary business, see Altman & Keesling, *Allocation of Income in State Taxation,* (2d ed.) p. 101.

> It is submitted that mere contribution is not a constitutionally appropriate test, and that the proper test for the rational relationship element of Due Process should involve the question of whether the in-state activity is "necessary" to one or more of the taxpayer's out-of-state functional operations; and if this finding is affirmative, then apportionment may be utilized as to only those functional operations of the taxpayer where this rational relationship exists. (Appellant's Brief p. 29-30).

First, the "rational relationship" requirement of the Due Process Clause, as set forth in *Moorman, supra,* is not a new concept in need of definition. It reflects the constitutional principle that states may not tax extraterritorial values. States do not tax extraterritorial values simply because one or more phases of a company's operations take place outside of the taxing state. *Butler Bros., supra; Bass, Ratcliff, supra; Ford Motor* v. *Beauchamp, supra.* Secondly, Exxon does not offer any authority or reasoning why the contribution or dependency test should be rejected. On its face, a contribution or dependence among business activities signifies a rational relationship. Moreover, the "necessary" test was implicitly rejected in *Butler Bros., supra,* The Court rejected Butler Bros.' argument that the sales in California had no effect on the purchasing power of the company. It reasoned that the same argument could be made in every state, yet there obviously is a cumulative effect of the sales in each state which contributes to the profitability of the purchasing operations. Once it is found that a business' in-state activities contribute to or are dependent upon its out-of-state activities, the nexus requirement of the Due Process Clause has been fulfilled. Finally, Exxon has focused a great deal of attention on the rational relationship between the business activities conducted within and without a State. This is not the relationship which is the subject of the Due Process requirement. "[T]he income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing state'." *Moorman,* 437 U.S. at 273. Any apportionment for-

mula can satisfy this test. (Of course, a three factor formula is more presumptively correct than a single factor in that it is representative of the economic factors of production.) The 'income attributed to the States' is the number generated by the apportionment formula. That formula incorporates 'values connected with the State'—property, payroll (cost of manufacturing) or sales. The income attributed to the state compared to total corporate (or unitary) income *is proportional to* the ratio of instate to total corporate (or unitary) property, payroll and/or sales. This is a rational relationship. *Hans Rees, supra,* has applicability only when the apportionment formula, in that case a single property factor, yields a figure which is out of all appropriate proportion to the business conducted in the State. The instant case is not one in which Exxon has shown that it is being taxed on 83% of its income while only 17% of its income had its source in the taxing state. This is a case where four years of sales in the state represented .41% of total company sales, yet Exxon is being taxed on .22% of total company net income.

CONCLUSION

For the foregoing reason, *Amici* respectfully request this Court to affirm the decision of the Wisconsin Supreme Court.

Respectfully submitted,

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IN THE

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October Term, 1979

No. 79-509

EXXON CORPORATION,
Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal From the Supreme Court of Wisconsin

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF THE MULTISTATE TAX COMMISSION AND PARTICIPATING STATES

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October Term, 1979
No. 79-509

EXXON CORPORATION,
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vs.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal From the Supreme Court of Wisconsin

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The Multistate Tax Commission (Commission) and the participating states listed herein respectfully move for leave to file the attached Brief *Amicus Curaie* in this case. The consent of the attorney for the Appellee has been obtained. The consent of the Appellant has been requested but has not been granted.

The interest of the Commission is as shown in the "Statement of Interest" section of the attached Brief. As

stated therein, this case is of fundamental importance to the Commission and all of the income tax states, including those states which have joined in this brief.

WHEREFORE, it is respectfully requested that this Court grant the Commission permission to file the accompanying amicus brief in this cause.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1979

NO. 79-509

EXXON CORPORATION,
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v.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal From the Supreme Court of Wisconsin

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-509

EXXON CORPORATION,
Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal From the Supreme Court of Wisconsin

BRIEF AMICUS CURIAE OF THE MULTISTATE TAX COMMISSION AND PARTICIPATING STATES

STATEMENT OF INTEREST

The Multistate Tax Commission (hereinafter referred to as the "MTC") is the administrative agency of the Multistate Tax Compact entered into currently by 19 states as full members and by 12 states as associate members.[1]

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1 The current regular members are the states of Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Mighigan, Missouri, Montana, Nebraska, New Mexico, Nevada, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. The associate members are the states of Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, Minnesota, New Jersey, Ohio, Pennsylvania, Tennessee, and West Virginia. (Ninth Annual Report, Multistate Tax Commission, June 30, 1976.)

The purposes of the Compact are to:

1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and other phases of tax administration.

4. Avoid duplicate taxation.[2]

The MTC seeks uniformity in state tax treatment of multistate-multinational businesses, and fairness and equity between such businesses and smaller in-state businesses. It is also working to advance effective enforcement of state corporate tax laws, and seeks policies which are simple and comprehensible for public officials and business taxpayers alike.

In fulfillment of these objectives in the area of state income taxation of multistate-multinational businesses, Article IV of the Compact sets forth the provisions of

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2 The constitutionality of the Compact was upheld in *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978), affirming 417 F. Supp. 795 (S.D.N.Y. 1976). This Court there noted that the Compact ". . . symbolized the recognition that, as applied to multistate businesses, traditional state tax administration was inefficient and costly to both State and taxpayer."

the Uniform Division of Income for Tax Purposes Act (UDITPA).[3]

It is important that this language be interpreted to carry out the purpose of the 29 states in adopting UDITPA. This purpose is to provide for uniformity and full accountability (without duplication) in the division of income for state income tax purposes by workable and rational division of income rules.

Pursuant to its authority under Article VII of the Compact, on February 21, 1973, the Commission approved revised uniform allocation and apportionment regulations which implement UDITPA. It is estimated

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3 UDITPA was promulgated by the National Conference of Commissioners on Uniform State Laws in 1957 (Uniform Laws Annotated, Vol. 9a, p. 448 et seq). It has been adopted by a great majority of the income tax states (Eleventh Annual Report of the Multistate Tax Commission (1977-1978), Appendix B, p. 28). Its purpose is to provide for the uniform allocation and apportionment of income for state income tax purposes by those states that adopt it. Section 1(a) defines "business income" which is subject to apportionment as:

> ". . . income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."

Section 1(e) defines "nonbusiness income" which is subject to specific allocation as ". . . all income other than business income."

that 18 states have adopted these regulations substantially in the form as adopted by the Commission.[4]

Within the framework of these regulations and otherwise, the Commission has sought to devise and participate in the development of practical and reasonable rules for the division of income among the respective states and other jurisdictions where multinational corporations conduct their business activities.

The objective of these practical and reasonable rules is to insure to each state a tax result reasonably related to the privileges and benefits conferred by each state on a multistate-multinational corporation without subjecting it to any duplicate taxation. In our judgment, this objective cannot be achieved by the "separate accounting" of Exxon[5] in the instant case. The fact that Exxon's executives and its other expert witnesses may conclude, as a general proposition, that Exxon has "separately accounted" for its marketing income under generally accepted accounting principles for internal management purposes is an inadequate resolution of the complexities involved in "separate accounting" for taxes on or measured by "net income." It is the detailed examination of every transaction and not the opinions and conclusions of experts which is involved in any proper application and policing of "separate ac-

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4 Results of a Survey on the Uniformity of State Laws by the State of Indiana dated February 15, 1977.

5 Although the taxpayer for the years involved was Humble Oil and Refining Co., since it was merged into Exxon and Exxon has assumed Humble's liabilities, we will refer to the taxpayer here as Exxon or appellant.

counting" by the states.[6] Furthermore, "separate accounting" is predicated on many arbitrary adjustments of income and expenses which cannot be resolved by any meaningful objective standards. Such adjustments can materially shift "net income" and involve endless controversy over proper attribution of net income to particular jurisdictions. It is because of this that "separate accounting" has generally been rejected by the

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6 See Dexter, "Article 9(4) of the United Kingdom Tax Treaty Should Be Reserved," Nolan, "The U.K. Tax Treaty Should Be Ratified Without Reservation," and Dexter, "A Closing Response to Mr. Nolan's Views," Special Report, *Tax Notes*, April 17, 1978, p. 403-416, where the authors debate the problems for the states associated with "separate accounting" as compared to formulary apportionment for worldwide "combined reporting" purposes. Both agree that "separate accounting," even in a "combined report," is not workable at the domestic level. As noted in Hellerstein, "The Unitary Business Principle and Multicorporate Enterprises: An Examination of the Major Controversies," 27 *The Tax Executive*, July 1975, No. 4 at p. 315:

> Over the years, separate accounting has come in for increased criticism, in theory as well as because of its impracticability and excessive costs. (Citing Albert H. Cohen, "Apportionment and Allocation Formulae and Factors Used by States in Levying Taxes Based on or Measured by Manufacturing, Distributive and Extraactive Corporations," Research Report prepared for Controllership Foundation (1954) and "State Taxation of Interstate Commerce," Report of the Special Subcommittee of the Judiciary Committee ("Willis Subcommittee"), 88th Congress, 2nd Session, H. Rep. No. 1480, Vol. 1, pp. 163-167 (1964).

states in favor of apportionment of unitary business income.[7]

The present case thus raises matters of vital concern to the MTC and the states. They are concerned with the proposition advanced by Exxon that under the Constitution of the United States, it is entitled to invalidate the application of the unitary principles to its vertically integrated petroleum and petroleum related business by "separate accounting." Any such constitutional prohibition would invalidate any reasonable application of the provisions of UDITPA and other state income tax attribution laws which require full apportionment of the unitary income of a unitary trade or business.

They are also concerned with problems associated with the taxation of income from intangible values and

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7 The Recommendations of the Task Force on Foreign Source Income, Committee on Ways & Means, U.S. House of Representatives, March 8, 1977, p. 28 (Rostenkowski Report) concluded:

> . . . [T]here is no significant disagreement that the states must use some type of apportionment formula [as distinguished from making an allocation of income and deductions by separate accounting], since there would be no practical way of determining what income of a company is earned within a state as opposed to being earned without other states [or in foreign countries.] Furthermore, all of the bills introduced in Congress provide for the apportionment of domestic income rather than separate accounting.
>
> See the bills cited in footnote 1 of *U.S. Steel, et al. v. Multistate Tax Commission, et al.*, *supra*, 434 U.S. 452 at 456 as examples.

properties which is not accounted for by the "separate accounting" of "operating income" derived from instate activities.[8]

The states are also concerned with the simplistic approach of Exxon in the record in this cause in dividing its far-flung activities into the neat captions of marketing, exploration and production, and refining. By its "separate accounting" method, Exxon attributes no net profits to a variety of its business activities, such as supply and purchasing and overall management. This simply demonstrates that it is free to attribute profit to any segments of its business which it chooses to and to ignore important aspects of its business as "non-profit" centers.

Exxon here challenges the constitutional validity of the Supreme Court of Wisconsin's decision which simply held, in conformity with the unitary decisions of this Court, that Exxon was conducting a unitary business both within and without Wisconsin and that Wisconsin was entitled to tax a reasonable portion of the income from Exxon's unitary business by application of a reasonable apportionment formula.

This case thus has far-reaching implications for states which impose taxes on or measured by net income on vertically integrated multistate-multinational

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8 In the instant case, Exxon contends that all that Wisconsin is constitutionally entitled to tax is the income of operating properties directly traceable to Wisconsin activities. Exxon here assumes that the difference between the "separate accounting" results and the apportionment results are attributable solely to the differences in the profit levels of marketing as contrasted to marketing plus exploration, production and refining. This is not the case.

businesses. It involves the fundamental question of whether these taxes may be constitutionally levied based on reasonable application of unitary principles. It is for this reason that the MTC and participating states have requested permission to participate in this cause.[9]

COUNTER STATEMENT OF QUESTIONS INVOLVED

We do not accept Exxon's Statement of Questions Involved. We believe that the only question here involved is as follows:

Whether the Supreme Court of Wisconsin interpreted and applied Wisconsin's corporate privilege tax measured by "net income" in a manner in conformity to the due process and commerce clause requirements of the United States Constitution when it rejected Exxon's "separate accounting" *per se* argument and held that Wisconsin could constitutionally measure its corporate privilege tax by a reasonable portion of Exxon's apportionable unitary income, even though it resulted in attributing income to Wisconsin in excess of Exxon's "separate accounting" results.

Subsidiary to this question are the following:

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9 There is yet another dimension to the "separate accounting" versus formulary apportionment issue which is clearly overlooked by the argument of Exxon. Wisconsin has not imposed an income tax on Exxon. The tax in question is a corporate privilege or franchise tax. It is imposed at the beginning of a tax year for the privilege of conducting corporate activities in Wisconsin for the ensuing year. For this privilege, the corporate privilege tax is *measured* by net income for the preceding year as defined under Wisconsin law.

1. Whether Exxon conducted an integrated unitary petroleum business partly within and without Wisconsin for the years in question.

2. If Exxon conducted an integrated unitary petroleum business partly within and without Wisconsin for the years in question, whether the State of Wisconsin conformed to due process limitations on its taxing powers when it measured its corporate privilege tax by that part of Exxon's unitary "net income" attributable to Wisconsin by a well-recognized three factor apportionment formula.

3. Whether the State of Wisconsin violated the due process clause when it measured Exxon's corporate privilege tax by net income apportionable to Wisconsin when the apportionment formula employed by the State of Wisconsin attributed an amount of net income to Wisconsin substantially in excess of the amount of "net income" which would be so attributed to Wisconsin by Exxon's internal "functional separate accounting."

4. If Exxon's "separate accounting" controls to determine what net income of Exxon can constitutionally be attributed to Wisconsin for corporate privilege tax measurement purposes, has Exxon properly "separately accounted" for its Wisconsin income by its accounting for its net income from its primary "separate accounting" profit centers of exploration and production, refining and marketing activities for state tax purposes.

5. Whether the State of Wisconsin could constitutionally include income from property with a fixed situs without the State of Wisconsin in apportionable income when the income from this property constituted a part

of Exxon's income from its integrated unitary petroleum business.[10]

STATEMENT OF THE CASE

A. History of the Proceedings.

Exxon reported its corporate franchise tax to Wisconsin for the years in question (1965-1968) by "separately accounting" for its "marketing" activities in Wisconsin. Upon audit, the Department of Revenue of Wisconsin disallowed the separate accounting method based on the conclusion that Exxon's business activities in Wisconsin were an integral unitary part of its activities both within and without Wisconsin and thus applied what is commonly referred to as the "unitary" method in lieu of Exxon's "separate accounting" method. Exxon appealed from this determination of the Department to the Wisconsin Tax Appeals Commission. In its decision and order, the Appeals Commission made certain findings of fact, which the circuit court set aside as erroneous. (Juris. St. App. 36-65)

Based on these factual findings, which alone demonstrate significant unitary ties between all aspects of Exxon's business operations, the Appeals Commission nevertheless found that the three main functional operating departments of Exxon, exploration and production (e & p), marketing and refining, were not a unitary

10 Since, in applying its apportional formula to Exxon, the Appellee excluded from apportionable income any income resulting from sales of crude oil to third parties at the well head, the Wisconsin Supreme Court did not have to consider whether income from such sales was properly excluded from apportionment as a matter of State Law or as a matter of Constitutional Law.

business. It based this legal conclusion on the finding that there was no economic dependence between Exxon's marketing operations and its e & p and refining functions (Jur. St. App. 69). The Appeals Commission also concluded that the apportionment formula utilized by the Appellee had the effect of imposing a tax on Exxon's e & p and refining net income (Jur. St. App. 71).

The Circuit Court found that there was economic dependence between Exxon's e & p, refining and marketing functions and that therefore the Appeals Commission erred as a matter of law in not so finding (Jur. St. App. 54). The Circuit Court then concluded:

> "That the business of Humble during the years in question considered as a whole both within and without Wisconsin constituted a unitary business . . .." (Jur. St. App. 54-55)

On appeal, the Supreme Court of Wisconsin held that Exxon's Wisconsin operations ". . . constituted an integral part of a unitary business subject to statutory apportionment . . . ." (Jur. St. App. 2)[11]

11 In so doing, it applied the definition of the term "unitary" relied on by the trial court and applied in *Interstate Finance Corp. v. Department of Taxation*, 28 Wis. 2d 262, 269, 137 N.W.2d 38 (965) which definition it found was in turn borrowed from the text authority Altman and Keesling, *Allocation of Income in State Taxation*, 2 ed., at p. 101. (Jur. St. App. p. 9) It then quoted that definition as being " '. . . the essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside of the state. If there is such a relationship, the business is unitary.' " (Jur. St. App. 9) As shown *infra*, this is generally accepted judicial definition of a unitary business.

The Supreme Court of Wisconsin, in finding that the marketing function contributed to the e & p and refining functions (Jur. St. App. 12) quoted as follows from the testimony of Mr. Luper, an Exxon Executive Vice President:

> ". . . [I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> "So, in the case of the petroleum industry . . . where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important [the exploration and production function] and the assured and stable outlet for products [the marketing function] is important and therefore when there are--when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time." (Jur. St. App. 14)

The Wisconsin Supreme Court then quoted at

length from a parallel case, *Humble Oil & Refining Co. v. Oregon Dept. of Rev.* 4 OTR 284 (1971), wherein the unitary nature of Humble's business of marketing, e & p, and refining was reviewed at length (Jur. St. App. 17-19, App. Br. 17-30).

Based on this Court's analysis in *Butler Bros. v. McColgan*, 315 U.S. 501 (1942), of the relationship of "separate accounting" to the apportionment of the unitary income of a unitary business, the Wisconsin Supreme Court concluded that the fact that the separate acounting of marketing operations in Wisconsin resulted in a loss for the disputed years is immaterial (Jur. St. App. 19-20).

As an adjunct to the "separate accounting" versus "unitary" issue, the Courts below considered an issue pertaining to the exclusion from apportionable income so-called "situs income" by reference to § 71.01(1) of Wisconsin's statutes. The Appellee had excluded production income attributed to third-party sales but had included production income attributed to the e & p function by Exxon's "separate accounting" for interfunctional transfers in apportionable income. Thus, production income from third-party sales is not at issue here. The only income at issue here is the production income used in the business.

In addition to providing for apportionment, this section states that income derived from specifically designated real or tangible personal property such as income from the operation of mines is taxable at the situs of the property, the Wisconsin statute interpreted the situs provision of § 71.07(1) of Wisconsin statutes (which also provides for apportionment of income derived from both in-state and out-of-state business), as pertaining to

taxation of income or loss from business not requiring apportionment. It then concluded that the apportionment of "situs income" may be required by the appellee to the extent that it is a part of the unitary income of a unitary business. (Jur. St. App. 22)

Exxon here asks this Court to reverse the foregoing holding of the Wisconsin Supreme Court on constitutional due process and commerce clause grounds.

B. Statement and Analysis of Facts.

While it is not the function of this Court to review an evidentiary record and the factual findings and conclusions of courts below, we believe that reference to the facts here are of extreme importance in resolving the constitutional issues posed by this appeal. We are here more concerned with the nature and configuration of the factual conclusions relied upon by Exxon and their general impact rather than with a recitation of facts as such.

At the hearing before the Appeals Commission, Exxon produced a substantial volume of evidence to prove that its operations were principally that of e & p, refining and marketing functions, and that these functions were not interdependent and that they generated their own profits which could be separately accounted for. It did not contend, however, that it was not a vertically integrated oil company or that all of its operations were not subject to strong centralized management, financing and control or that its operating departments did not have a substantial exchange of goods and services as between themselves and as between various levels of its centralized management. In fact, it produced evidence which establishes the existence of all the unitary ties between the various segments of its business

activities which have been relied upon by the courts to define the contours of a unitary business.

Exxon did not contend that, *as a matter of fact*, there was not any interdependence of operations between its centralized management and financing and between its e & p, refining and marketing functions and between each of these functions. For example, it did not contend that its crude oil from its production facilities did not flow to its refining facilities and from its refining facilities to its marketing facilities as an integrated part of its transportation and other corporate functions. In short, it did not argue with the factual pattern found to exist by the Oregon Tax Court in *Humble Oil & Refining Co. v. Oregon Dept. of Rev., supra.*

Neither did Exxon contend that its integrated activities as a single corporate entity, conducting a vertically integrated petroleum business, did not result in overall economy to all of its operating departments. Exxon thus premises its constitutional arguments on the fact that, irrespective of the unitary and integrated nature of its operations, including that of its marketing, refining and production, it can "separately account" for its profits from its marketing operations as distinguished from its profits from its refining operations and its exploration and production operations by generally accepted accounting principles. Furthermore, it made no attempt to establish the validity of any "separate accounting" of its expenses related to any of its functions or for its "net income" or losses of its other functions and activities.

The foregoing is supported by an analysis of the evidence in this cause.

Exxon's first witness, Oral L. Luper, testified, as an

expert, to the overall responsibilities of three levels of top management which consisted of *Corporate Management, Coordination and Services Management* and *Operations Management* (Exh. 20, A755; A187-189). The operating departments (e & p, refining, marketing, etc.) were subject to these three levels of top management control (Exh. 20, A755).

Corporate Management comprised the top executive management. It consisted of the Board of Directors, Executive Committee, President, Chairman of the Board, Chief Executive Officer, and Directors-in-Charge. The directors, in addition to being full-time members of the Board of Directors, were the executive officers of Exxon, having general responsibilities for specified operating departments for the *Coordination and Services Management* function (A755).

The *Coordination and Services Management* comprised the second tier of Management (A188). It was composed of corporate staff departments with the responsibility of providing the overall specialized corporate services that were needed by Exxon (A188-189). This included the departments of Corporate Planning, Secretary's, Supply, Treasury, Comptroller, Tax, Law, Public Relations, Employee Relations, General Services, Medical and Aviation (Exh. A755; A188-A192).

Corporate Planning was responsible for assisting and developing the overall company strategies. It advised the Board as to how to maximize the effectiveness of the overall operations of Exxon (A189).

The *Secretary's department*, among other things, was responsible for executive compensation, executive development and training, and general advice in corporate affairs (A189).

The *Treasury department* was responsible for all of the financial resources, the development of financial policy and procedures, and the maintenance of banking relations. This department also developed plans for the appropriate financing of Exxon's activities and provided an analysis of the financial aspects of any proposed investments (A190).

The *Comptroller's department* was responsible for the overall maintenance of the accounting system, procedures and plans related to capital budgeting, and for financial reporting and financial forecasting (A190). It was also in charge of the computer program and internal audit and control (A190).

The *Supply department* (a non-profit center) coordinated the demand for and the movement of products in regard to the functional departments of e & p, refining, marketing and transportation (A252). It executed contracts for the purchase of such things as tires, batteries and accessories sold by the marketing department (A257-A258) and handled exchange agreements (A245, A257). The exchange agreement for gasoline sold in Wisconsin for the years in question was negotiated in the Houston office by the Supply department (A279). The Supply department would arrange for crude oil to be delivered to the refineries (A281) and the movement of gasoline to marketing operations which came primarily from Exxon's refineries and exchanges (A233).

Mr. John J. Jeager, as manager of crude oil of the Supply department, had the principal responsibility:

> . . . to manage the crude oil supplies of the company in the United

> States. This broadly covered the disposition of all the company's produced crude and responsibility to say that the company's refineries had adequate supplies of the proper types of crude to meet their requirements . . . . (A296-A297)

In further testifying as to the functions of Exxon's Supply department, he stated:

> Well, in addition to the movement of crude, that is the buy and sell, the transportation activities, we had some planning responsibilities with regard to expansion of refineries, what future supplies might be, and we had responsibility to appraise the market to determine what proper prices should be for the crude oil, and it was my group that would develop pricing strategies and pricing-actual pricing changes that would be made, and recommend such changes to the board of directors. (A297)

Operations Management was responsible for directing the operating activities of the individual functional segments of Appellant (A193) which consisted of e & p, refining, marketing, marine, coal and shale oil, minerals, and land management (Exh. 20, A755, A193-A194).

The rest (fourth level) of Appellant's management structure was at the operating department level (Exh.

20, A755; A193). Top executive management adopted a "functional profitability independence" policy for these individual operating departments as the most effective management tool to measure the performance of the departments and to improve their operations (A193).

The sources of capital for investment in Wisconsin property came from the corporate treasury (A259). Top level promotions and overall retirement policies and salary levels of operating department personnel were not determined at the operating department level; but they were controlled by corporate staff departments (A263-A264). Furthermore, the corporate staff was involved in labor relations (A265). The budget of each operating department was approved at the overall top management levels (A265). It was the policy to transfer employees between departments as a matter of routine procedure (A269). Mr. Luper further testified that the term "vertically integrated petroleum company" is ". . . normally applied to a petroleum company that is involved in all the major operating functions, principal operating segments of the business." (A272)

The three principal operating departments (e & p, refining and marketing) were treated as separate profit centers (A193-A197). There was in existence a system of providing values for the transfer of raw materials and products interfunctionally between departments to provide a basis for determining the functional profit or loss, for each of these major operating segments (A204). The objective of the system was to provide a basis of valuing transfers which would *approximate* the same results *as if* one separate independent company had *negotiated with* another separate independent company

(A207). Each functional department was also recognized as an investment center (A204). In regard thereto, Mr. Luper testified:

> I might add here that the attractiveness of an investment in refineries is directly related to the adequacy and stability of the source of raw materials and crude. The attractiveness of this refinery investment is also directly related to the adequacy and assured outlet for the products, and, this, of course, means that where assured and stable supplies of raw materials and assured outlets for products exist, the refining investments become attractive . . . . (A204-A205)

> By the same token, the marketing department is responsible--is interested in the type and quality of products that are received from the refining department so this just means, I think, that when you have the exploration and production activities and the assured market outlets, there is less opportunity for disruption due to fluctuation and the demand and supply balances. (A205)

For interfunctional transfer purposes, it was company policy that the transfer of values for products and raw materials should be based upon a competitive wholesale market price (A206). However, Mr. Luper testified:

> For some products, of course, there is no readily available quoted wholesale market value or price, and in these cases the representatives of our marketing department and our refining department with both of their knowledge of the market, knowledge of the products, *negotiate* with each other on an arm's length basis in an adversary position to try to *negotiate the appropriate transfer value* to the best of their ability, market oriented. (A206) (emphasis added)

He also noted that there is greater precision in interfunctional pricing between exploration and production functions than between refining and the marketing functions (A208).

However, according to Mr. Luper, all of these interfunctional transfer prices are entirely adequate for accounting, regulatory and tax purposes (A208-A209).

In answer to the question of why separate operating departments of Exxon were organized under one corporate entity, Mr. Luper testified:

> [I]n any industry which is highly capitol intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.

> So, in the case of the petroleum industry it is--where you have high capitol investments in refineries, *the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore . . . when these segments are under a single corporate entity*, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time. (A224-A225; emphasis added)

In regard to how a combination of the separate functional departments of e & p, refining and marketing under one corporate entity affect profit stabilities, Mr. Luper testified:

> Here again the placing individual segments under one corporate entity does provide greater profit stability for the reason that the factors . . . which may effect one department may be offset by the factors existing in another department. And this produces a greater opportunity for profit stability. (A225)
>
> . . . . .
>
> The combination of the individual segments under one corporate entity does reduce the impact

> of risk. The operations of the exploration and production departments have a very high degree of risk, and much higher than other types of industrial activity. So when this type of operation is combined under an entity with other operations with less risk, it provides a diversification and gives some protection against the risk hazard. (A225)

Mr. Luper was asked whether any other reasons came to mind for combining the separate operating functions in one corporate entity (A225). He answered as follows:

> Yes, yes. Again [by] putting the individual segments under one corporate entity provides an opportunity to provide a corporate staff, corporate staff services which I described earlier in my testimony that enable the entities to attract high quality of staff employees. The cost and economies are obtained because the more efficient and effective use of these staff groups when they are made available on a corporate-wide basis. (A226)

On cross-examination, Mr. Luper testified:

> I testified this morning that the attractiveness of refinery investments are directly related to a stable and

> assured supply of crude oil and raw materials. (A281) . . . .
>
> [A]s I have said before, the existence of a stable and assured market outlet is directly related to the refinery investment. (A239-A240)

Whether the supply department would dispose of Exxon's crude production to outsiders depended upon the economies to Exxon which were related to the location of its refineries, crude oil and the availability of transportation facilities for movement of the crude to Exxon's refineries (A299).

The competitive price for crude which was utilized by Exxon for accounting for e & p function profits was related to "posted-field prices" of the purchasers but many times there is more than one posting because there is more than one purchasing company (A300-A301). In regard to the particular posted field prices in any particular field, Mr. Jeager testified:

> Yes, as I said awhile ago, a company who wants to buy crude, they, of course, want to buy it at the lowest price so they--in order to keep the price down. On the other hand, if there is competition in the buying, that tends to drive the price up, but there is an upper limit to what the company can pay because of the cost of moving to the refinery, manufacturing the product, and then competition in the product market.

> Now all these factors get worked into what . . ., the competitive prices will be in any particular field. (A301)

During the years in question, Exxon had surplus refining capacity and refined all of its products (A317). This resulted from the fact that there was an inadequate market for Exxon's refined products and not because of any shortage of crude (A319-A320). The gasoline marketed by Exxon came primarily from its own refineries or from exchange agreements (A233).

Because of the depletion deduction, it was to the tax advantage of Exxon to maximize its revenues from crude oil and gas production (A277). It attributed any profit from the supply department activities pertaining to disposition of crude oil to the e & p department (A313-A314).

Mr. Campbell, a staff commerce advisor in the supply department of Exxon, who was involved in the exchange of products by Exxon east of the Rocky Mountains, also testified on behalf of Exxon (A340). His work included exchanges of finished products, exchanges of crude for the refineries, the setting up of exchanges (long-term and spot arrangements) to cover emergencies (A340). He testified that the supply department was also involved in the direct purchase or sale of products for Exxon (A340). It utilized the use of the "Platt's oil gram" for pricing of various petroleum products which were transferred internally (A340-A345). The products were sold between the refining and the market department based on a formula tied to "Platt's oil gram."

. . . [I]t was a discounted formula based on the history we had of our third-party sales to Standard Oil of Kentucky. The transfer price to marketing from refinery was on a *negotiated discount* from the Platt's oil gram. The discount factor was established around 1961 or possibly 1962 and was a result of *negotiations* between marketing and refining based on the history of the Standard Oil of Kentucky contract.

> These prices are a day-to-day type price and historically if someone wanted to make a long-term contract or a large contract, they could effectively negotiate a discount off of this price, and that is how we established transfer price from marketing to refining. (A343) (emphasis added).

The proprietary products of Exxon were not covered in any posting in Platt's oil gram. However, the base stock covered by the Platt's oil gram was used as a starting point in the negotiations between the refining function and marketing function of Exxon (A347). The interfunctional transfers of products between Exxon's operating departments involved price build-up and negotiation factors (A347-A348).

According to Exxon's witnesses, there is nothing unique in the oil industry in Exxon's functional accounting approach for the dividing of profits between e & p, refining and marketing. As stated by Mr. Wehner, an expert accounting witness:

> It has been my experience that oil companies use the functional profitability independence for measuring the performance of their various operations. They measure their performance of the e & p function by applying posted field prices and fiske-type formulas to determine the values of the products and to measure the profitability and success and operations of the personnel, and by the respect of the other functions, the refining function, they measure the performance of that operation by having a net income determination by that particular function and carried over into marketing and each of the other functions, so that they use this for a number of purposes, probably the principal of which is to measure the performance of their personnel and their investments with respect to those functional operations. (A436-A437)

Mr. Wehner also testified that accounting for tax purposes is quite a different matter than accounting for financial and management purposes (A455). Furthermore, he was not qualified to answer the question of the relevance of functional accounting to attribution of income by an apportionment method (A455). He further indicated that utilization of total company sales as compared with total company net income represents one means of testing the reasonableness of the application of an apportionment formula (A455). Mr. Wehner described the unitary business as a

series of business operations which are so related that they are *completely dependent and contributory* to each other in the final business operation (A456; A458).

Exxon next called Professor Ezra Solomon as an expert economic witness to testify as to what constitutes an integrated unitary business. He defined a unitary business as a ". . . minimum unit which provides economic viability." (A493; A512) He further stated that in his opinion if any component of a business is not *vital or necessary to another component* of a business, these components of the business are not unitary (A494-A502). Mr. Solomon also testified that the very fact that independent refineries, producers and marketers exist on a fairly large scale in the oil industry suggests that Exxon's e & p function, refining function and marketing function constitute non-unitary businesses (A507). Mr. Solomon did indicate that these functions would be better off profit-wise if combined in an integrated company (A509; A512). He would not consider centralized management and control important (A497-A498). He testified that the accounting for profits for tax purposes and the accounting for profits for managerial and financial purposes do not lead to the same accounting result (A510-A511).

From the foregoing, it is evident that Exxon's witnesses were generally testifying as to the integrity of Exxon's internal functional accounting system for the attribution of some of its overall gross income, namely, that relating to the e & p function, the refining function and the marketing function. The testimony further indicates that this accounting was based upon negotiations between various operating departments as related to "posted field prices" for crude oil, "Platt's oil gram" for

selected products of the refineries and the Fiske formula for the development of contract prices for natural gas.

The use of "Platt's oil gram" and the "posted field price" to determine the transfer value of products from one function to another is admittedly the result of marketing conditions. However, there is nothing in the record to indicate how the location of Exxon's refineries and its market outlets affect either of these prices as pertains to Exxon's crude oil production, its refinery operations and its products. Also, if Exxon had no marketing and thus dumped its crude oil and refined products on the market, there is no evidence of the impact of this on the assumed market conditions on which it based its interfunctional transfer pricing.

One very significant aspect of the Exxon's business is the transfer of products and crude oil by exchange agreements with other oil companies. These transfers obviously result from negotiated contractual arrangements. Yet, there is no indication how such agreements impact the various functional operations of the Exxon's business. The record indicates that the most significant aspect of Exxon's business for the years in question was the need to find a market for its products. This follows from the fact that there was a surplus of crude oil on the market and a surplus of refining capacity at Appellant's refineries for the years in question. Obviously, under such circumstances, Exxon's marketing activities had a considerable impact on all operational functions of the company.

Thus, the record leaves many uncertainties in regard to the reliability of Exxon's functional accounting for the e & p, refining and marketing functions. Obviously, this accounting is dependent upon a great many

of assumptions, including assumed negotiations, contracts, and prices assumed with third parties pertaining to Exxon's operations both within and without the three principle functional departments. While there is admittedly substantial economies in all of Exxon's functions due to the integrated nature of its operations, there is no indication in the record as to how such economies are to be assigned on a functional accounting basis.

While there is testimony that all of Exxon's operating departments are dependent upon contributions of integrated centralized management, financing, planning and control, including acquisitions and dispositions of Exxon's property between its various departments, the record is void of any system utilized by Exxon, from an accounting viewpoint or otherwise, for the attribution of the expenses of centralized management and control to its operating departments.

While Exxon's e & p, refining and marketing functions were subject to strong centralized management and control and to three levels of supervision within the organizational structure of Exxon, there is no explanation in the record as to why Exxon's profits were substantially all attributed to these functions rather than to other functional operations. For example, why was the supply department function treated as a "non-profit" center? Why should not some of the profits of Exxon be attributed to the very important and integrated activities of the supply department?

An examination of Exxon's federal income tax returns (page 1 of federal form 1120) set forth as part of Exhibit 28 (A761-A765) indicates that over one-third of its gross receipts for the years in question (1965-1968) are attributable to centralized administration. This

amounts to approximately 6.7 to 11.1 times Exxon's federal taxable income for the years 1965-1968. The record is silent as to how the costs of these centralized administrative functions of the three levels of top management were attributable to the operating departments. Obviously, the reliability of the method of apportionment of these administrative costs is critical to any "separate accounting." Furthermore, the fact that they must be apportioned indicates the need for ascertaining the net income of the operating departments by apportionment rather than "separate accounting."

The "separate accounting" evidence and analysis of Exxon only touches selected aspects of its total business operations. For example, transportation undoubtedly is a major component of Exxon's business, as well as supply. It has a direct bearing on the profit levels of the e & p, refining and marketing functions. Yet the record is silent as to this significant aspect of Exxon's business. Such losses would substantially reduce "net income."

In short, to arrive at its division of profits between its operating functions of e & p, refining and marketing, Exxon has relied on certain aspects of its internal accounting and certain aspects of the integrated operations it conducted for the years in question. It has completely ignored a vast amount of its other business operations and accounting procedures. All of these accounting results in turn are related to theoretical assumed market conditions which would not exist if it made the third-party transfers which it assumed took place by the functional allocation of its net income.

What the market might be for Exxon's crude oil and refined products if it had not integrated these functions with other functions of its business, including

transportation and marketing, is not known. It is self-evident that the sale of Exxon's crude oil in the open market and its refined products in the open market for the years in question would have had a significant impact on those markets. Thus, "Platt's oil gram" and "posted field price" standards as used by Exxon in this case are also theoretical. Exxon's internal accounting, apart from the fact of its integrated operations as a unitary business, is highly speculative and misleading.

The foregoing limitations on Exxon's "separate accounting" approach is substantiated by a letter of December 16, 1975 from A.L. Monroe, Exxon Comptroller to the late Senator Philip A. Hart in connection with the hearings of his subcommittee on anti-trust and monopolies concerning congressional divestiture legislation pertaining to the petroleum industry. On December 5, 1976, Senator Hart wrote Exxon and several other major oil companies requesting their profit and loss statements and balance sheets, audited or unaudited, covering separately production, transportation, refining, lease and marketing. On December 16, 1975, A.L. Monroe, Exxon's Comptroller, replied as follows to this inquiry of Senator Hart:

> We have prepared schedules showing the condensed profit and loss statement for each of the four major segments of the company's operations:
>
> U.S. upstream.
>
> U.S. downstream.
>
> Foreign upstream.

> Foreign downstream.
>
> This segregation of earnings is consistent with data that we have supplied to other congressional committees. The operations contained in each of the above segments are indicated on the individual schedules. *Exxon's financial records are maintained on a corporate basis rather than a functional or segment basis.* Since there are market prices for most crude oils, it is possible to divide earnings on an upstream/downstream basis. *However, a further division of earnings is not meaningful due to the difficulties related to transfer prices and the allocation of costs.* (The Congressional Record--Senate, March 26, 1976, p. S 4395)

As further indicated by Senator Hart:

> On December 5, I wrote to the presidents of several major oil companies requesting certain data, including an "item 5" which called for "profit and loss statements and balance sheets, audited or unaudited, covering separately production, transportation, refineries, and marketing."

After further correspondence, Exxon's comptroller, Mr. A. L. Monroe, replied and stated unequivocally:

> As we indicated in our first response and as further discussed with a member of your staff, Exxon Corporation's financial records are not maintained on a functional or segment basis similar to those categories set forth in your item 5.

Mr. Monroe's letter went on to explain:

> As for further statements of revenue and expenditures data directly attributable to each of the above-mentioned groupings [crude production, refining, marketing and transportation], our earlier response, together with the above clarifications, indicate that our corporate records are not maintained in that manner, nor do our independent public accountants prepare such allocations. As we *indicated in our December 16 response and in responses to other Congressional Committees*, to the FTC's Line of Business and Croporate (sic) Patterns reports, and to the FASB's proposal for segment reporting, *the petroleum business is unitary in nature*. The most meaningful segmentation of our operations is the "upstream"/"downstream" segmentation previously furnished for the years 1972-74. Further *breakdowns require many allocations and asumptions*, which could lead

> to erroneous comparisons of data between various companies and hence erroneous conclusions.
>
> Similar responses were received from other major oil companies from whom this data also was requested. (Cong. Record--Senate, 94th Cong., 2nd Sess., Vol. 122, No. 43, March 25, 1976, p. 1; emphasis added)

Based on the foregoing, which is substantiated by the gaps in the record in this cause, Exxon's evidence concerning "separate accounting" of its e & p function, refining function and marketing function must be viewed as fragmentary and incomplete.[12]

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12 The nature of the integration of Exxon's operations as a unitary business and the advantages of the same are commented as follows by a prepared statement of Exxon Co., USA., in the hearings before the subcommittee on anti-trust and monopoly of the Committee on the Judiciary United States Senate, 94th Congress. First Session, on S2387 and related bills, Vertical Integration Part I, hearings September 23-26, October 29-31, November 12, and 19, 1975:

> **II. THE EFFICIENCIES OF VERTICAL INTEGRATION**
>
> Vertical integration is an efficient form of industrial organization which is commonly used by a great number of American companies, both large and small, in order to better serve the consumer at lower costs. In addition to petroleum, some other industries which have integrated companies include autos, food, newspapers, steel, tobacco, beer, machinery, communications, papers, nonferrous metals, chemicals, rubber products, textiles, and stone, glass, and clay.
>
> For instance, many newspapers and publishers have integrated backward into forest product companies and paper manufacturing companies to assure an adequate supply of newsprint. Many newspapers also have company-owned transportation equipment to insure efficient distribution of

(footnote 12 continued on next page)

SUMMARY OF ARGUMENT

There can be no question that for the years in question Exxon conducted an integrated unitary petroleum business, including its operating departments of e & p, refining and marketing and that this business was

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their product. Moreover, integration also takes the form of syndication whereby certain papers put feature writers under contract and distribute the stories exclusively to syndicate members.

Just as in the petroleum industry and the newspaper industry, vertical integration allows the companies in many industries to deal with uncertainty in a company's economic environment by providing for reliability in terms of quantity of supply, product quality, price, and service. Vertical integration also allows better coordination of expectations and activities between stages of production with a high degree of interdependency and, therefore, results in a reduction of required inventories and working capital. Moreover, these aspects of vertical integration improve a company's access to capital markets--not only in terms of a lower cost of capital because of lower risk, but also because of its increased ability to communicate to investors the entire interdependent investment picture.

Vertical integration also effects savings in transactions and communications costs in terms of reductions in operating and support staffs, and the concomitant elimination or reduction in reports and data handling, reduced costs of negotiations, reduced need for settlement of disputes, and better communication because of common training, experience, linguistics code, and community of interests among employees. All of these advantages of vertical integration obviously add up to cost savings to the consumer.

Neither long- nor short-term contracts are an adequate substitute for vertical integration in this adaptive, sequential decision-making process. Efficient supply from a petroleum company, as with many companies in other integrated industries, requires large and expensive investment in special-purpose, long-life equipment. Thus, optional investment considerations favor the award of long-term contracts to

(footnote 12 continued on next page)

conducted in part in the State of Wisconsin. The fundamental issue in this cause, then, is whether on the record and in the context of a tax on or measured by "net

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permit the supplier to amortize his investment with confidence.

Although long-term contracts can result in an industrial structure very similar to that existing under vertical integration, long-term contracts are not adequate substitutes for vertical integration. Contingent supply relations must be exhaustively stipulated in long-term contracts to prevent conflict over contract ambiguities. Unfortunately, this is often precluded by the bounds of rationality and the inability to foresee the future. Those stipulations which are specified are often costly in themselves. Suppliers demand a substantial premium when they commit their resources to a particular buyer under specified conditions for a long period of time. Moreover, costs multiply when changing technology and market circumstances force renegotiation. Needed amendments are costly--not only in terms of time and money, but also in the distortions in the decision-making processes they invariably create. Such distortions can include the total cancellation of plans because of the inability of a party to honor a long-term contract. Many industries have experienced severe hardships when suppliers have been unable to deliver vital raw materials.

III. VERTICAL INTEGRATION IN THE PETROLEUM INDUSTRY

Like other industries, various segments of the petroleum industry have found it more efficient to integrate on a forward and backward basis into other segments . . .

Vertical integration is a logical and effective structure for the petroleum industry.

The petroleum industry is characterized by large capital investments and complex operations, both physically and in the business sense. Vertical integration has been the logical and natural outgrowth of firms seeking to efficiently utilize capital intensive facilities to smoothly and effectively conduct their operations so they can deliver products to the consumer in a timely and economic manner. These operations include a multitude of discrete physical and commercial transactions including gravity, magnetics, and seismic

(footnote 12 continued on next page)

income," Exxon's "separate accounting" is the due process constitutional standard to determine the validity of an otherwise reasonable apportionment of the unitary

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(footnote 12 continued)

surveys; geological and geophysical studies; lease purchases; exploratory and development drilling; construction and installation of producing facilities; production, gathering and transportation of crude and natural gas, and the construction of the facilities to do so; design, construction, and operation of gas processing facilities and refineries; storage of crude and products; sale of crude not compatible with processing facilities and the purchase of substitutes and supplemental volumes; design of product quality to customer specifications or requirements; product quality control; packaging and bulk transportation of products; distribution to retail sales points; and, finally, consumer sales with the associated billing and collection processes. Each of these more than twenty-five discrete activities is in itself surrounded by significant planning and involves multiple decision-making steps. Vertical integration is merely the interrelating of these processes through a unified management organization and system. The efficiency that can result is obvious. The beneficiary is the consumer.

As suggested earlier, the complexity of modern petroleum operations requires a close and continuing functional interaction on scheduling and control. The potential value for this close coordination can best be appreciated by examining the operations of a large complex operation such as Exxon USA. Each day in 1974 Exxon produced on average 700 MB/D of crude and condensate; purchased 113 MB/D from royalty owners, purchased 737 MB/D from other domestic producers, and imported 257 MB/D from foreign sources; and in turn, sold 780 MB/D to other domestic users. Our domestic production occurs at over 10,000 individual wells scattered through 23 states in the U.S. Imports are received in the Gulf of Mexico and on the East and West Coasts.

After production, coordination must be arranged for the following materials, processes, products, and facilities:

(footnote 12 continued on next page)

income of a vertically integrated unitary trade or business. This issue was squarely raised and disposed of by this Court in *Butler Bros. v. McColgan*, 315 U.S. 501 (1942). This Court there held that "separate accounting" was totally irrelevant in determining the constitutionality of an otherwise valid apportionment formula when applied to the net income of a unitary business. Furthermore, disposition of the "separate accounting" issue in *Butler Bros.* is totally consistent with and is supported by all of the apportionment decisions of this Court whether in the context of an *ad valorem* property tax *(Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), rehearing 166 U.S. 185 (1897)); or a franchise "net worth" tax *(Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911); *Ford Motor Co. v. Beauchamp*, 308 U.S. 313 (1939)); or a net income tax *(Bass, Ratcliff & Gretton, Ltd. v. New York Tax Commission*, 266 U.S. 271 (1924); *Maxwell v. Kent-Coffey Mfg. Co.*, 204 N.C. 265, 168 S.E. 397 (1933), aff'd 291 U.S. 642 (1934); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *National Leather Co. v. Massachusetts*, 277 U.S. 413 (1927); *Underwood Typewriter Co. v. Chamberlain*, 245 U.S. 111 (1920); *Hans Rees' Sons, Inc. v. North Carolina*, 283

(footnote 12 continued)

Number of refineries/plants	7
Number of processing units	184
Number of different types of processes	49
Number of different crudes used	100
Grades of petroleum products manufactured	1,300
Bulk plants	921
Number of marketing terminals	102
Number of retail outlets	24,600

U.S. 123 (1931); and *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978)). All of these decisions, and those that follow their holdings, support the proposition that all of the income or values of a unitary business carried on in part within a taxing state are constitutionally subject to a reasonable rule of apportionment, irrespective of "separate accounting" results.

Contrary to Exxon's argument, neither *Hans Rees'*, *supra*, nor *Moorman*, *supra*, support the proposition that "separate accounting" as reflected on the books and records of a taxpayer controls constitutional consequences for the attribution of net income for state taxes on or measured by "net income." In many of the referred-to cases, the taxpayer sought to rely on separate accounting. This was true in *Bass, Ratcliff & Gretton* and the *Underwood* income tax cases. It was equally true in the net worth cases of *Flint v. Stone Tracy Co.* and *Ford Motor Co. v. Beauchamp* and the *ad valorem* property tax case of *Adams Express Co., supra*. In fact, as a general proposition, income attribution disputes between taxpayers and state taxing authorities have generally centered around the taxpayer's efforts to invalidate apportionment results by "separate accounting."[13] These efforts have been uniformly rejected by the courts.

Undoubtedly, the courts have uniformly rejected "separate accounting" as either the statutory or constitutional standard for the attribution of the net income of an integrated unitary business because "separate accounting" does not represent any reliable objective standard for the attribution of income. This is amply demonstrated by the record in this cause. Admittedly, the "separate accounting" results, which Exxon contends are controlling here, are the product of Exxon's internal accounting policies. However, these policies are based upon hypothetical market conditions and hypothetical transactions with unrelated third parties. In addition, there are no objective standards by which to test the validity of Exxon's "separate accounting" for its net income. Exxon is here contending for a self-determination of its corporate tax liability by arguing that its "separate accounting" controls for due process of law purposes.

13 Essentially, Exxon and its amicus curiae would embroil the states in the complex problems pertaining to the implementation of "arms' length" standards to determine the extent of the states' taxing powers within the purview of the due process clause of the United States Constitution. A comparison of application of the "arms' length" standard as contrasted to the unitary standard and the complexity of the arms' length standard is discussed at length in a Note, "Multinational Corporations and Income Allocation Under Section 482 of the Internal Revenue Code," 89 Harv. L. Rev. 1202 (1976).

The due process clause of the United States Constitution has never been so construed by this Court. As this Court indicated in *Moorman Mfg. Co. v. Bair, supra*, and cases of like import, the due process clause only requires that a state tax be related to the activities carried on by a taxpayer within the state. There must only be a sufficient instate presence (1) to satisfy "nexus" requirements and (2) to establish a relationship of the tax to the instate taxable activities of the taxpayer. These dual requirements are satisfied for state taxes on or measured by net income if a reasonable apportionment formula is applied to the total net income of a unitary trade or business carried on in part within the taxing state and the taxpayer has not proved that extraterritorial values are taxed.

The fact that Exxon by "separate accounting" would attribute none of its "separately accounted" for net income from its e & p and refining departments to Wisconsin is totally irrelevant to resolution of the due

process question if the operations of its e & p and refining departments constitute a part of its integrated unitary business of marketing which it carried on in part in Wisconsin for the years in question and reasonable apportionment rules are applied by Wisconsin. In other words, the due process connection is established and the due process requirements fulfilled by resolution of the question of whether or not Exxon's marketing operations in Wisconsin are integrated with and constitute a part of Exxon's unitary business operations of refining and e & p.

In any event, why "separate accounting" should not control for due process purposes is amply demonstrated by the record in this cause. Exxon's "separate accounting" suffers from the inherent defect that no one knows what Exxon's profits would have been for the years in question *but for* its Wisconsin marketing activity or but for Exxon's marketing activities everywhere. Of controlling significance here is the fact that Exxon made no profits whatsoever until it sold its products through its marketing operations. Exxon realized profits from its refining and e & p departments only as a result of its marketing operations.

In determining the "net income" of the various departments of Exxon, Exxon's "separate accounting" is a product only of theoretical transactions with unrelated third parties. It is nothing more nor less than the result of the management judgments of Exxon's executives in conformity with generally accepted accounting and economic practices of the oil industry. Such management judgments should not control the due process limitations on state's taxing power.

In the instant case, a *slight error* or *shift* in Exxon's "separate accounting" for "net income" between its vari-

ous complex and interrelated activities and functions could completely eliminate any profit for the years in question which would be attributable to Exxon's marketing operations by its "separate accounting." Furthermore, a *slight shift* in Exxon's "separate accounting" in favor of its marketing or centralized operations could completely eliminate the controversy in this appeal which is based solely on a differential between e & p and marketing "separate accounting." Furthermore, Exxon made no effort on the record to justify its accounting for its expenses as distinguished from its gross income from its e & p, refining and marketing activities.

The controlling fact here is that there is no objective standard to test the validity of Exxon's "separate accounting" and that such "separate accounting" results are subject to change at the sole discretion of Exxon. As a pragmatic proposition, then, Exxon's "separate accounting" argument would require the states to accept, as a due process constitutional standard, any taxpayer's internal accounting for the distribution of "net income." The only alternative would be for the states to attempt a transaction by transaction analysis of a taxpayer's business activities and test the validity of such an analysis by illusive and uncertain accounting concepts and practices by reference to hypothetical third-party transactions. In the instant case, it may be asked, what reasonable objective criteria was available to Wisconsin to refute the "separate accounting" of Exxon which was justified by Exxon's expert witnesses? Furthermore, if such objective criteria in fact existed, was it administratively feasible for Wisconsin to expend the thousands of audit hours necessary to apply such criteria to all of Exxon's internal departmental transactions? The answer is "no" for the simple reason that the direct cost to both Wisconsin and Exxon in the application of such audit practices would

far exceed the amount of tax dollars in controversy.

However, no such objective standards exist to test the validity of Exxon's "separate accounting." The fact that Exxon's "separate accounting" is speculative is proven by the necessity of Exxon's reliance on expert testimony to prove its case. This testimony is necessary because there is no other standard of proof available. Yet, in denouncing Wisconsin's audit results as arbitrary and unconstitutional, Exxon argues that "On adverse examination the auditor for the Wisconsin Department of Revenue . . . admitted he could not really challenge the separate accounting results. (A627-A635)" (App. Br. 4) The key question in this controversy is "How could he have done so?" He wasn't present or privy to Exxon's accounting decisions. The only information available to him for examination were the accounting products of such decisions which were related to hypothetical transactions which, of course, never in fact took place.

Thus, because of the uncertainties, hypothetical assumptions and complexity in any "separate accounting" approach for the attribution of "net income" of a multistate-multinational taxpayer to the states, irrespective of judicial precedent, Exxon has not established any valid reason why its "separate accounting" rather than unitary principles should control the disposition of its due process argument.

Exxon's due process and commerce clause arguments pertaining to the "situs income issue" is subject to the same inherent defects as its "separate accounting." This argument is but an adjunct to Exxon's "separate accounting" due process argument. This Court in *Moorman, supra,* specifically recognized that income

"source" principles (separate accounting) were irrelevant in determining the validity of an apportionment formula. Furthermore, it specifically held there that the commerce clause does not prevent the risk of multiple taxation which exists either from the states' utilization of different apportionment formulas or other specific attribution rules, including separate accounting and specific allocation.

ARGUMENT

A. The Appellant Conducted An Integrated Unitary Petroleum Business Partly Within And Without Wisconsin For The Years In Question. Any Reasonable Definition And Application Of What Constitutes A Unitary Business Clearly Establishes That Exxon Conducted A "Unitary" Business Of All Of Its Departments For The Years In Question And That All Of Its "Net Income" From Such Business, Including That From Its Situsted Property, Is Subject To Apportionment.

Since what constitutes a "unitary business" is a judicial concept developed to determine the constitutional scope of state taxing powers, particularly in the application of apportionment rules rather than separate accounting rules for the attribution of tax bases among the respective states, it is the judicial definition of this term which controls here. In this portion of the brief we will examine the tests employed by the judiciary to resolve this issue and then apply those tests to the facts and circumstances of this case.

1. The Judicial Definitions of What Constitutes a "Unitary" Business Establish that Exxon's Vertically Integrated Petroleum and Petroleum Related Business is "Unitary."

The unit rule of taxation first emerged in the state *ad valorem* property tax cases. In the latter part of the

19th century and the first part of the 20th century, this Court was confronted with a series of cases in the application of the unit rule to state *ad valorem* property taxation of interstate utilities in reference to federal constitutional restrictions on the states' power and jurisdiction to tax.[14]

In *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), rehearing 166 U.S. 185 (1897), this Court summarized its prior holdings:

> As to railroad, telegraph, and sleeping-car companies, engaged in interstate commerce, it has often been held by this court that their property in the several states through which their lines or business extended, might be valued as a unit for the

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14 *See, State R.R. Tax Cases*, 92 U.S. 575 (1875); *Kentucky R.R. Tax Cases*, 115 U.S. 321 (1885); *Western U. Tel. Co. v. Massachusetts*, 125 U.S. 530 (1887); *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18 (1890); *Maine v. Grand Trunk Ry. Co.*, 142 U.S. 217 (1891); *Pittsburgh, Cin., Chi. & St. L. Ry. Co. v. Backus*, 154 U.S. 421 (1894); *Cleveland, Cin., Chi. & St. L. Ry. Co. v. Backus*, 154 U.S. 439 (1894); *American Refrig. Transit Co. v. Hall*, 174 U.S. 70 (1899).

> In *State R.R. Tax Cases*, the Court noted:
>
> That the franchise, capital stock, business, and profits of all corporations are liable to taxation in the place where they do business, and by the State which creates them, admits of no dispute at this day. "Nothing can be more certain in legal decisions," says this court in Society for Savings v. Coite, 6 Wall, 607, "than that the privileges and franchises of a private corporation . . . may be taxed by a State for the support of a State government." State Freight Tax Case, 15 Wall. 232; State Tax on Gross Receipts, 15 Wall. 284. (92 U.S. 603).

The argument was made by the taxpayers that the rolling stock, capital stock, and franchise or personal property which had a taxable situs at the principal place of business of the corporation could not be taxed by any other county, city or town. In answering this argument, the Court simply noted that the taxation of property at the principal place of business (commercial domicile) was a rule that could be changed by legislation.

> purposes of taxation, taking into consideration the uses to which it was put and all the elements making up aggregate value, and that a proportion of the whole fairly and properly ascertained might be taxed by the particular state, without violating any Federal restriction.

In *Adams Express Co., supra*, the Court then defined the unit subject to apportionment as a combination of the taxpayer's properties and values which constituted a "unit of use and management." However, it held that this unity constituted more than mere unity of ownership but rather a unity of use resulting from the nature of the business (165 U.S. at 221, 222).

In *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, supra*, 266 U.S. 271 (1924) and *Underwood Typewriter Co. v. Chamberlain, supra*, 245 U.S. 113 (1920), this Court recognized that vertically integrated manufacturing and selling activities constituted a unitary business, the income from which was subject to formulary apportionment. In *Butler Bros. v. McColgan, supra*, 315 U.S. 501 (1942), unity was found on the basis of centralized management and centralized purchasing.

In *Maxwell v. Kent-Coffey Mfg. Co.*, 204 N.C. 265, 168 S.E., 397 (1933), aff'd without opinion, 291 U.S. 642 (1934), the court found that the term unitary business "is simply descriptive, and primarily means that the concern to which it is applied is carrying on one kind of a business, the component parts of which are too closely connected and necessary to each other to justify division or separate consideration, as independent units." (168 S.E. at 399) In *Wurlitzer Co v. State Tax Commission*, 35

N.Y.2d 100, 315 N.E.2d 805 (1974), the New York court treated a parent and its captive financial subsidiary as conducting a unitary business based primarily on unity of management and secondarily on unity of use. In *W.S. Dickey Clay Mfg. Co. v. Dickinson*, 200 Tenn. 25, 289 S.W.2d 533 (1956), the unity of ownership, centralized management and use (to a greater or lesser extent) resulted in a unitary business.

The Pennsylvania courts, in a series of decisions,[15] applied the interdepenence of the opertating units or divisions test to determine the existence of a unitary business. As there stated:

> [I]t is virtually impossible to envision a successful multiform claim [not unitary] based upon a separation of vertical functions of a corporation where the selling function deals in the products of the manufacturing and/or wholesaling functions. . . . [P]erformance by the corporate whole of policy, administrative, research and similar functions for otherwise independently operating units does

15 *Commonwealth v. Advance-Wilson Indus., Inc.*, 456 Pa. 200, 317 A.2d 642 (1974); *Morewood Realty Corp. v. Commonwealth*, 6 Pa. Commw. Ct. 244, 294 A.2d 219 (1972), aff'd, *Commonwealth v. Morewood Realty Corp.*, 458 Pa. 204, 327 A.2d 328 (1974); *Commonwealth v. ACF Indus., Inc.*, 441 Pa. 129, 271 A.2d 273 (1970); *Commonwealth v. Ford Motor Co.*, 350 Pa. 236, 38 A.2d 329 (1944); *Commonwealth v. Quaker Oats Co.*, 350 Pa. 253, 38 A.2d 325 (1944); *Commonwealth v. Minnesota Mining & Mfg. Co.*, 402 Pa. 612, 168 A.2d 560 (1961); *Logan Clay Prod. Co. v. Commonwealth*, 11 Pa. Commw. Ct. 629, 315 A.2d 346 (1974).

> not vitiate multiformity [non-unitary] any more than does their common but independent contributions of benefits to the corporate whole. *(Commonwealth v. ACF Indus., Inc.*, 441 Pa. 129, 271 A.2d 273, 279 [1970])

From *Western Auto Supply Co. v. Commissioner of Taxation*, 245 Minn. 346, 71 N.W.2d 797 (1955), "The test of whether a business is unitary is whether its various parts are interdependent and of mutual benefit so as to form one business unit rather than separate business entities and not whether the operating experience of the parts is the same in all places." The business there involved was unitary based on "reflected dependency, mutual contribution, and mutual benefit." (71 N.W.2d at 805) *Cf. Fleming v. Oklahoma Tax Comm'n*, 157 F.2d 888 (10th Cir. 1946).

What constitutes a unitary business has been the subject matter of considerable litigation in the states of California and Oregon, both in the single and multiple corporate (combined reporting) setting.[16] The California Supreme Court accepted the concept of unitary business enunciated by decisions of this Court. After noting that separate ac-

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16 California cases: *Appeal of F.W. Woolworth Co.*, [July 31, 1972] Cal. Tax Rep. (CCH) par. 204-806; *Chase Brass & Copper Co., Inc. v. Franchise Tax Bd.*, 10 Cal. App. 3d 496, 87 Cal. Rptr. 239 (1970). *cert. denied*, 400 U.S. 961 (1970); *Honolulu Oil Corp. v. Franchise Tax Bd.*, 60 Cal. 2d 417, 386 P.2d 40, 34 Cal. Rptr. 552 (1963); *Superior Oil Co. v. Franchise Tax Bd.*, 60 Cal. 2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963); *Butler Bros. v. McColgan*, 17 Cal. 2d 664, 111 P.2d 334 (1941), *aff'd*, 315 U.S. 501 (1942); *Edison California Stores, Inc. v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16 (1947).

(footnote 16 continued on next page)

counting cannot be relied upon to disprove the propriety and presumption of fairness of formula allocation and after examination of the facts, it concluded:

> In accordance with the foregoing analysis, it is our opinion that the unitary nature of appellant's business is definitely established by the presence of the following circumstances: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation. *(Butler Bros. v. McColgan*, 17 Cal. 2d 664, 111 P.2d 334, 341 (1941), *aff'd*, 315 U.S.501 (1942).

In *Edison California Stores, Inc. v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16 (1947), clarification was added. "If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary; otherwise, if there is no such dependency, the busi-

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(footnote 16 continued)

Oregon cases: *Coca Cola Co. v. Department of Rev.*, 271 Or. 517, 533 P.2d 788 (1975); *Hamilton Mgmt. Corp. v. State Tax Comm'n*, 253 Or. 602, 457 P.2d 486 (1969); *John I. Hass, Inc. v. Ellis*, 227 Or. 170, 361 P.2d 820 (1961); *Zale-Salem, Inc. v. State Tax Comm'n*, 237 Or. 261, 391 P.2d 601 (1964); *Humble Oil & Refining Co. v. Department of Rev.*, 4 OTR 284 (1971).

ness within the state may be considered to be separate." (30 Cal. 2d at 481, 183 P.2d at 21)

The California test was further refined in *Superior Oil Co. v. Franchise Tax Board*, 60 Cal.2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963). The California tax authorities had argued that even though the California business operations contributed substantially to the taxpayer's out-of-state business and the California operations were substantially dependent upon the out-of-state operations, "[I]t must appear that the operations within and without the state are 'necessary and essential' to each other and to the functioning of the business as a whole."(386 P.2d at 37, 34 Cal. Rptr. at 549) For this argument the California taxing authorities relied on language in *Edison California Stores, supra*, wherein the court had used the word, "essential." In response to this argument, the court held that the use of the word "essential" in *Edison* was unfortunate and this Court in *Butler Bros.* simply held that the San Francisco branch contributed its adequate share to the advantages of centralized management of the unitary enterprise and to the total net income earned. In reference to *Butler Bros.*, it then concluded:

> [T]he test was not one based on essential activities, but rather based on contributing activities, and this court arrived at a similar result in Edison California Stores v. McColgan, *supra*, 30 Cal. 2d 472, at p. 481, 183 P.2d 16, at p. 21, wherein it concluded that operations are unitary if the business done within the state "is dependent upon or contributes to" the over-all operations. (386 P.2d at 38, 34 Cal. Rptr. at 550)

In applying the three unities and general dependency test of California, the court in *Chase Brass & Copper Co., Inc. v. Franchise Tax Board*, 10 Cal. App. 3d 496, 87 Cal Rptr. 239 (1970), *cert. denied*, 400 U.S. 961 (1970), determined, by major reliance on the overall control of the parent over the operations of its subsidiaries through management decisions at the highest level, that a parent and its subsidiary corporations conducted a unitary business.

In *Honolulu Oil Corp. v. Franchise Tax Board*, 60 Cal. 2d 417, 386 P.2d 40, 34 Cal. Rptr. 552 (1963) the California Franchise Tax Board alleged an absence of unity at the operating level which resulted in a lack of unity between Honolulu Oil's exploration and development activities (which were largely out-of-state) and its California local production and processing operations. Relying primarily on the facts of centralized control and operation of the entire business, the court found unity there because Honolulu Oil's business done within the state was dependent upon and contributed to the business done without the state.[17]

In *Chase Brass & Copper Co., Inc. v. Franchise Tax Board*, 10 Cal. App. 3d 496, 87 Cal. Rptr. 239 (1970),

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17 The court in *Honolulu Oil Corp.* relied on its decision in *Superior Oil Co. v. Franchise Tax Board*, 60 Cal. 2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963), to uphold the unitary concept. There was lacking in the *Superior Oil Co.* case any unity at the operational level. The court grounded its conclusion of a unitary operation in the *Superior Oil Co.* case on the basis that Superior's operations in California were substantially dependent upon out-of-state operations on (a) transfer of funds from out-of-state and borrowing on out-of-state assets to finance California operations; (b) legal counselling provided by company counsel outside of the state; (c) transfer of equipment and materials from out-of-state branches; (d) fiscal control; (e) technical and laboratory assistance and information; and (f) the transfer of employees from other branches.

cert. denied, 400 U.S. 961 (1970), the court placed considerable significance on the centralized executive force of the parent to determine that the parent and its subsidiary corporations conducted a unitary business.

> The integration of executive forces is an element of exceeding importance. It is top level management which is credited (or, in the case of failure or indifferent results, debited) with the effects of corporate enterprises. Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, and to exert their best efforts, not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott is an invaluable resource. (10 Cal. App. 3d at 504)

In summing up the contours of a unitary business, Frank M. Keesling and John S. Warren, in an article entitled, "The Unitary Concept in the Allocation of Income," 12 Hastings L. Journal 42 (1960), stated:

> Briefly stated, for the purposes of allocation of income, a business may be defined as a separately owned group of activities each of which contributes to the production or earning of a given identifiable item of income, no portion of which can be segregated and specifically identified as being attributable to any one of the activities or any combination of activities less than the total number included in the group. (12 Hastings L. Journal 49)

Wilbur F. Lavelle, in an article entitled, "What Constitutes a Unitary Business," Southern California Tax Institute 239 (1973), defines a unitary business to be composed of the operations which ". . . are integrated with, dependent upon, or contribute to each other and the operations of the taxpayer as a whole." 1973 U.S.C. Law Center Tax Institute 246 (1973). Lavelle indicated that vertically integrated businesses with strong centralized management are generally considered unitary businesses.

The Oregon courts have followed the basic tests laid down by the California courts in determining whether a business is unitary. The Oregon Supreme Court in *Zale-Salem, Inc. v. State Tax Commission*, 237 Or. 261, 391 P.2d 601 (1964), held, on authority of *Edison California Stores*, and *Butler Bros.*, that parent and subsidiary corporations, engaged in the jewelry business, were conducting a unitary business.[18]

2. *Application of Judicial Definitions of What Constitutes a "Unitary" Business to Particular Factual Settings*

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18 *See also, Coca Cola Co. v. Department of Rev.*, 271 Or. 517, 533 P.2d 788 (1975). The Kansas Supreme Court defined unitary business in *Crawford Mfg. Co. v. State Comm'n of Rev. & Tax*, 180 Kan. 352, 304 P.2d 504 (1956) in essentially the same way.

Support Treatment of Exxon's Petroleum and Petroleum Related Business as "Unitary."

A cardinal example of a unitary business is a railroad system. In *Fleming v. Oklahoma Tax Commission, supra*, 157 F.2d 888 (10th Cir. 1946), the Tenth Circuit had no trouble in dtermining that a railroad system constituted a unitary business.

> The very nature of a vast continental or interstate transportation system brings it especially within this concept of a unitary business. A railroad may likened to a spider's web, in which all the strands are necessary to the common design and each contributes its necessary part to a single goal. It may be true, as urged by the Railroad, that the Chicago to Denver branch could be operated profitably by itself and that the income realized from its operation can be ascertained. It does not, however, follow that it could be operated as profitably by itself or that its income would be as great as it is as a part of a large railway network in which other parts lessen overhead burdens or funnel business to the system, which ultimately finds its way to this branch. No doubt its connection with the rest of the system brings it business which otherwise might well go elsewhere. To this extent it is dependent upon the rest of the system, and it cannot be said that no part of the income realized from the operation of this branch does not accrue by virtue of its connection with a large railway transportation system. (157 F.2d at 891)

In *Butler Bros. v. McColgan, supra*, the question was whether a wholesale dry goods and general merchandising business constituted a unitary business or whether the specific wholesale locations could be treated as separate businesses. As a result of the activities of a central buying division, a central advertising division and a central accounting and management division, the Supreme Court of California and this Court held that the business of Butler Brothers was unitary.

The Supreme Court of Minnesota arrived at a comparable result in reference to a Missouri corporation engaged in the retail and wholesale merchandising of automotive parts and accessories and other merchandise on a nationwide basis. In *Western Auto Supply Co. v. Commissioner of Taxation*, 245 Minn. 346, 71 N.W.2d 797 (1955), the taxpayer sought to divorce its wholesaling activity from its retailing activity and separately account for its retailing activity in Minnesota. The court there noted the relationship of the centralized activity of the taxpayer to its retail operations and noted the reciprocity of their activities.

> The taxpayer, in its analysis of the sources of its profit, treats its business as if it were made up of independent, separate business units. The fact remains that the buying profit and the administrative profit . . . [were] created by the operation of the entire

business unit, through the coordinated and standardized activity of numerous stores throughout the country which made possible the central purchasing, the central management, the warehousing as carried on, and the advertising methods adopted. The stores in Minnesota contributed in part to make all this possible, and the multiple-formula method simply allocates a fair share of the profit to Minnesota, a share corresponding to the contribution of the taxpayer's Minnesota operation (measured by its Minnesota property, payroll, and sales activity) to the existence and operation of the taxpayer's entire business unit. (71 N.W. 2d at 805)

In *Edison California Stores, Inc. v. McColgan, supra,* the court found that a parent and its subsidiary corporations engaged in the purchasing and retailing of ladies shoes, accessories, and costume jewelry conducted a unitary business. It could not distinguish the *Edison* case factually from the *Butler Bros.* case, *supra.*

A parent and its wholly owned subsidiaries owning and operating retail jewelry stores also have been adjudged a unitary business. *Zale-Salem, Inc. v. State Tax Comm'n, supra.* The parent company exercised strict accounting and management control and supervision over the separately incorporated local stores.

A corporation, such as Exxon, engaged in the business of manufacturing, sale and distribution of products (a

vertically integrated business), has generally been held to be engaged in a unitary business.[19] This simply follows from the fact that "net income" is a result of various integrated activities and transactions culminating in sales; and that it is not possible to determine what part of "net income" is attributable to the separate but integrated activities of manufacture, sale, distribution, and so forth.

In *Humble Oil and Refining Co. v. Department of Rev.*, 4 OTR 284 (1971), the court found that an integrated oil company was unitary:

> Humble Oil and Refining Company is a large vertically integrated, corporation engaged nationwide in all phases of the petroleum industry, from discovery through production and manufacture to marketing. It has unity of ownership, operations, management, control and products; and strong centralized credit, purchasing, advertising, accounting and legal services. All segments of plaintiff's business have a great deal in common and contribute to and are dependent upon each other. The plaintiff is actually a single interrelated unitary business operation. The component parts, including those in Oregon, are too closely connected and necessary to each other to be considered as independent units. . . .

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19 *Underwood Typewriter Co. v. Chamberlain,* 245 U.S. 113 (1920). "The profits of the corporation were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sale in other states." *Id.* at 120.

> Producing in one state and selling in another depends upon a multitude of interdependent operations, and although the petroleum Humble sold in Oregon was not its own production but that of a third party, the sales nevertheless were made possible by the company's own production. If plaintiff wasn't producing it wouldn't be selling, and what plaintiff did in Oregon was not due solely to conditions here, but was dependent upon the market elsewhere and upon plaintiff's production and manufacturing elsewhere. The marketing in Oregon was an integrated part of plaintiff's nationwide business and undoubtedly was beneficial to the corporation as a whole. It was not a completely separate, independent or local endeavor. Plaintiff's production and refining conform to the demands of the nationwide market, and the court believes plaintiff expanded into Oregon to increase demand for its products so that it could increase production and refining and thus increase profits and its stature in the industry. (*Id.* at 292-93)

In *Coca-Cola Co. v. Department of Rev., supra*, the Supreme Court of Oregon had no difficulty in finding that the Coca-Cola Company and its wholly owned bottling subsidiaries conducted a unitary business subject to apportionment. Factors included a substantial dependency of the subsidiaries on the parent's centralized management and control and a flow of products from the parent to the

subsidiaries. Coca-Cola's "arms'-length" dealings with its subsidiaries was held to be immaterial to resolution of the "unitary" issue.

John Deere Plow Co. of Moline v. Franchise Tax Board, 38 Cal. 2d 214, 238 P.2d 569 (1951), is a good illustration of the factual pattern necessary to be developed to show interdependence and centralized control of the business enterprise giving rise to the application of the unitary concept.

In the referred-to cases, where there was a substantial flow of goods between the different departments or corporations constituting the unitary group as well as strong centralized management and control, a unitary business was found to exist. Since the profits were traceable directly in part to centralized operations and interfunctional operations, a unitary business was found to exist.

3. *Application of the Unitary Tests to the Facts of this Case Clearly Establishes that Exxon Conducted a Unitary Business for the Years in Question.*

The application of any reasonable definition of what constitutes a unitary business to the admittedly integrated petroleum business of Exxon with its strong centralized and complex management and supervision and the interrelations of its various operation departments (including a flow of goods) unequivocally establishes that it was conducting a unitary business in regard to all of its operating departments involved in its gas and oil enterprises. In fact,

every criteria that can be used to describe a unitary business was present in regard to Appellant's activities for the years in question. This is demonstrated by the Statement and Analysis of Facts, *supra*, at pages 14-36 of this brief.

Any doubt about that is dispelled by the participation of Exxon and other major oil companies and their spokesmen in the hearings before the Subcommittee on Anti-Trust and Monopoly of the Committee on the Judiciary United States Senate 94th Congress, 1st Session on S2387 and related bills entitled, "The Petroleum Industry-Vertical Integration (S2387)." Most of the testimony on behalf of the oil companies in those proceedings characterized the splitting up of the integrated functions of major integrated oil companies as "dismemberment." These spokesmen further testified that any such dismemberment would change the whole nature and structure of the petroleum industry in the United States. In fact, in those hearings, as indicated above, footnote 12 at pages 35-39, Exxon told this Committee that its e & p, refining, marketing and transportation functional activities constituted a unitary business and that its books and records were kept on a company and not a functional department basis. Therefore, Exxon could not give the Committee a separate profit statement for its major operating functions of production, refining, marketing and transportation.

This case does raise, then, only the fundamental question of whether accounting principles which are utilized for internal accounting and management purposes determines the due process limitations of state taxing powers as pertains to a vertically integrated unitary business. If Exxon is right in its argument, judicial precedent pertaining to the application of apportionment and unitary principles which have been analyzed above are meaningless pieces of paper. For, we can imagine no stronger case for the application of unitary principles than that demonstrated by the unitary operations of a wholly integrated vertical petroleum business. The facts pertaining to Humble's unitary operations set forth in *Humble*, *supra*, by the Oregon Tax Court--which are not in conflict and are supported by the record in this case--alone support this conclusion. If Exxon's "separate accounting" controls here, we can imagine no multistate business which could not attribute its profits to the respective states--irrespective of the unitary nature of the business--by some method of generally accepted accounting.

B. Exxon's activities in Wisconsin for the years in question clearly exceeded any due process requirements inasmuch as it conducted substantial business activities in Wisconsin for the years in question which exceeded any minimum nexus due process requirement and inasmuch as its Wisconsin operations were related to and not disassociated from its activities which produced the "net income" subject to apportionment by Wisconsin.

The general due process standard applicable to an apportioned state income tax is stated as follows in *Northwestern States Portland Cement Co. v. Minnesota*, *supra*, 358 U.S. 450:

> Nor will the argument that the exactions contravene the Due Process Clause bear scrutiny. The taxes imposed are levied only on that portion of the taxpayer's net income which arises from its activities within

the taxing State. These activities form a sufficient "nexus between such a tax and transactions within a state for which the tax is an exaction." *Wisconsin v. J.C. Penney Co.*, *supra*, at 445. . . . The record is without conflict that both corporations engage in substantial income-producing activity in the taxing States. . . . As was said in *Wisconsin v. J.C. Penney Co.*, *supra*, the "controlling question is whether the state has given anything for which it can ask return." Since by "the practical operation of [the] tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred . . ." it "is free to pursue its own fiscal policies, unembarrassed by the Constitution . . ." *Id.*, at 444. (358 U.S. at 464, 465)

As otherwise stated in *Moorman*, *supra:*

> The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate business. First, no tax may be imposed unless there is some minimal connection between those activities and the taxing State. *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756. . . . Second, the income attributed to the State for tax purposes must be rationally related to "values connected with the taxing state." *"Norfolk & Western R. Co. v. Missouri*, 390 U.S. 317, 325 (437 U.S. 267 at 272-273)

Notwithstanding the fact that its activities in Wisconsin clearly exceeded any due process nexus requirements and notwithstanding the fact that the net income subject to tax was reasonably related to its Wisconsin activities by application of unitary principles, Exxon attempts to attribute its e & p and refining income to out-of-state sources for due process purposes by "separate accounting."

In so doing, it relies on two faulty premises, namely, (1) that Wisconsin is imposing an income tax on its income from its out-of-state e & p and refining activities; and (2) that the income derived from these activities is totally disassociated from and unrelated to its Wisconsin business activities and operations. Neither of these propositions is true.

The fact that income or properties is included in the tax base subject to apportionment which by "separate accounting" would be attributable to out-of-state sources and activities has never triggered invalidation of an apportionment formula, so long as the taxpayer has not shown that the apportionment result reached extra-territorial values or income. *Butler Bros. v. McColgan*, 315 U.S. 501 (1942).

In contending that Wisconsin is attempting to tax its income derived from out-of-state activities or sources, Exxon misconstrues the operative effect of the formula method of computing taxable income. In answering Moorman Manufacturing Co.'s argument that the Iowa single-sales-

factor apportionment formula sought to tax income attributable to Moorman's manufacturing operations in Illinois, this Court stated in *Moorman*:

> Since 1934 Iowa has used the formula method of computing taxable income. *This method, unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State.* The single-factor formula used by Iowa, therefore, generally will not produce a figure that represents the actual profits earned within the State. But the same is true of the Illinois three-factor formula. Both will occasionally over-reflect or under-reflect income attributable to the taxing State. Yet despite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula. See, *e.g., Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113; *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271; *Ford Motor Co. v. Beauchamp*, 308 U.S. 331. (437 U.S. 267 at 273; emphasis added)

Thus, Exxon's due process of law argument must be rejected because it has not shown that the income attributed to Wisconsin by the apportionment formula was not "rationally related by 'values connected with the taxing state'--*Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 325." *(Moorman*, 437 U.S. 267 at 273)

What Exxon completely ignores in its due process clause argument is that *unitary apportionment* principles--*not "separate accounting"* source principles--apply without exception, when a state seeks to tax integrated business operations which are conducted both within and without its borders. Exxon argues that "separate accounting" rules are relevant within the limited context of the attribution of its gross income from its e & p, refining and marketing activities and that apportionment rules and unitary principles otherwise apply. Apportionment principles would apparently pertain to those substantial expenses which are common to its overall business operations (characterized as "administrative" on its federal income tax returns and amounting to in excess of one-third of its 27.1 billion dollars in gross income for the years in question [A761-A765]). This is an inappropriate, hybrid method of attributing income to either Exxon's Wisconsin income sources or income producing activities.

As indicated in an article entitled, "Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business," by Jerome R. Hellerstein, XXI National Tax Journal 487, 496:

> The underlying justification for applying an apportionment formula to the overall tax base of a multistate business is that there exists a unitary enterprise being carried on in more than one state. The formula is a device for attributing to the taxing state

its share of the overall tax measure that admittedly is attributable ony in part to the state. . . . By applying the typical three factor formula, the property, receipts and payroll ratios of all branches, subsidiaries and affiliates are taken into account in determining apportionment ratios, which are then applied to the tax base of the entire business.

[A]t the center of many of the cases, the crucial controversy has been the delineation of the contours of a unitary business. (Footnotes omitted)

Starting with the early utility property tax cases, this Court has uniformly upheld the apportionment of the entire properties, values or income attributable to a unitary business by an apportionment formula which has not been demonstrated by the taxpayer by clear and cogent evidence to tax extraterritorial income or values.

In the *Adams Express Co.* case, *supra*, this Court held that all of the property of the express company which was used in its trade or business, including its intangible assets, were properly subject to apportionment for ad valorem property tax purposes. Furthermore, this Court there held that:

> There is here no attempt to tax property having a situs outside of the state, but only to place a just value on that within. Presumptively, all the property of the corporation or company is held and used for the purposes of its business, and the value of its capital stock and bonds is the value of only that property so held and used. (167 U.S. 227)

This Court therefore concluded in the *Adams Express Co.* case that the total market value of the stock of the express company could be taken into consideration in valuing its properties within the taxing state, even though its intangibles had a specific situs outside the taxing state at the "commercial domicile."

It is thus clear that the *Adams Express Co.* cases and cases relied on therein clearly establish a unit rule or unitary concept for state tax purposes and permits a state to determine the instate privilege, property or income by reference to the total privileges, property or income of the multistate business if there is a unitary relationship between the instate activities or property of the business and its total activities or properties everywhere. They also establish the proposition that the state of "situs" of property has no special claim to tax the properties or values connected with the unitary business and that all such values and properties, wherever located, are appropriately included in the tax base subject to apportionment.

The principles of these early "unit rule" cases were subsequently uniformly applied by this Court to corporate "net worth" franchise and "net income" taxes. In the application of the "unit rule" to corporate franchise taxes, this Court in *Flint v. Stone Tracy Co., supra,* 220 U.S. 107 (1911) and *Ford Motor Co. v. Beauchamp, supra,* 308 U.S. 331 (1939) upheld the apportionment of all the property used in a unitary business. It there recognized that the total properties of large multistate-multinational corporations contributed substantially to their business which they conducted in the various states.

This Court in *Ford Motor Co., supra*, held that its decisions in *Bass, Ratcliff & Gretton v. State Tax Commission, supra*, 266 U.S. 271 (1924) and *National Leather Co. v. Massachusetts*, 277 U.S. 413 (1927), were directly applicable.

In *Bass, Ratcliff & Gretton v. State Tax Commission, supra*, 266 U.S. 271 (1924), this Court stated:

> In *Wallace v. Hines*, 253 U.S. 66, 69, it was recognized that a State, in imposing an excise tax upon foreign corporations in respect to doing business within the State, may look to the property of such corporations beyond its borders to "get the true value of the things within, when they are part of an organic system of wide extent," giving the local property a value above that which it would otherwise possess, and may therefore take into account property situated elsewhere when it "can be seen in some plain and fairly intelligible way that it adds to the value of the (property) and the rights exercised in the State." This is directly applicable to the carrying on of a unitary business of manufacturing and sale partly within and partly without the State.

The unit rule of taxation, which included a reasonable apportionment of all properties and values, as developed in the *Adams Express Co.* cases was first applied to taxes on or measured by net income in *Underwood Typewriter Co. v. Chamberlain, supra*. In the *Underwood* case, a tangible property apportionment factor was used to apportion

to Connecticut manufacturing activities ". . . income upon which the corporation is required to pay a tax to the United States." (254 U.S. 117, 118) In challenging the constitutionality of the apportionment formula, the taxpayer contended that the net income included income from properties not connected with its Connecticut manufacturing business (254 U.S. 114-116). In disposing of the taxpayer's arguments, this Court focused its attention solely on the validity of the apportionment result.

Four years later, in *Bass, Ratcliff & Gretton, supra*, this Court held that the world-wide property and income of a British unitary enterprise were a necessary part of the apportionment computations in measuring the true value of its income attributable to New York. The taxpayer was found to be "a British corporation, engaged in brewing and selling Bass's ale" which it imported and sold in New York City and Chicago. (*id.*, at p. 278) It had world-wide net income of $2,185,600, but "the Company, as reported to the United States by "separate accounting," had no net income upon which it was subject to a federal income tax." (*id.*, at p. 279) New York imposed a 3% tax which Bass paid under protest.

On appeal, Bass contended that the tax was imposed "upon a portion of its net income derived from business carried on outside of the United States . . ." (*id.*, at p. 280). This Court decisively rejected this contention. It held that Bass ". . . carried on the *unitary* business of manufacturing and selling ale, in which its profits were *earned in a series of transactions* beginning with manufacture in England and ending in sales in New York . . ." (*id.*, at p. 282). Having found Bass to be a unitary business operation, this Court affirmed that a fair measuring of taxes due the State required an apportionment of all of Bass' income from its unitary business.

Again, in *Butler Bros. v. McColgan*, 315 U.S. 501 (1942), this Court applied the unit rule it had expressed in the *Adams Express Co.* cases, *supra*, and its observations in *Flint v. Stone Tracy Co.*, *supra*, and *Ford Motor Co. v. Beauchamp*, *supra*, in determining the validity of the apportionment result challenged in *Butler Bros.* It there found:

> At least since *Adams Express Co. v. Ohio*, 165 U.S. 194, 17 S. Ct. 305, this Court has recognized that the unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis.
>
> . . . . .
>
> We cannot say that property, payroll, and sales are inappropriate ingredients of an apportionment formula. We agree with the Supreme Court of California that *these factors may properly be deemed to reflect "the relative contribution of the activities in the various states to the production of the total unitary income," so as to allocate to California its just proportion of the profits earned from this unitary business. And no showing has been made that income unconnected with the unitary business has been used in the formula.* (Emphasis added, 315 U.S. 507-508)

In *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978), this Court stated:

> The "unitary business" technique involves calculating a corporate taxpayer's net income on the basis of all phases of the operation of a single enterprise (*e.g.*, production of components, assembly, packing, distribution, sales), *even if located outside the jurisdiction*. The portion of that income attributable to activities within the taxing State is then determined by means of an apportionment formula. *See, e.g., Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920). (434 U.S. 473, n. 25; emphasis added)
>
> . . . . .
>
> Individual States are free to employ the unitary-business standard. *Underwood Typewriter Co. v. Chamberlain*, *supra*; accord, *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924). (434 U.S. 474, n. 26)

As the above decisions amply demonstrate, the fact that the Wisconsin tax base, prior to apportionment, included income from out-of-state properties and activities is totally irrelevant. To the extent income is attributable to out-of-state properties and activities, this is reflected in a determination of apportionable unitary income and the apportionment factors.

Notwithstanding the clear and unequivocal holdings of the foregoing cases, Exxon contends that the unitary principles have no due process significance if their application produces a tax result substantially in excess of a tax result arrived at by "separate accounting." What Exxon fails to realize is that this Court has never held that "separate accounting" *per se* invalidates the tax result arrived at by applying a reasonable apportionment formula to the total unitary tax base of a multistate-multinational corporation.

The relationship of what Appellant characterizes as the unitary *per se* principle to "separate accounting" was specifically considered by this Court in its disposition of *Butler Bros. v. McColgan, supra.* As Exxon does here, the taxpayer in *Butler Bros.*, by reliance on *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931), sought to invalidate the California apportionment formula result by "separate accounting." As noted by this Court in *Butler Bros.*:

> *Hans Rees' Sons v. North Carolina*, 283 U.S. 123, constitutes appellant's chief support in its attack on the formula employed and the tax imposed by California. Appellant maintains that the use of the formula in question resulted in converting a loss of $82,851 into a profit of over $93,500 and that the difference of some $175,000 has either been created out of nothing or has been appropriated by California from other states. (315 U.S. at 506)

This Court in disposing of Butler Bros.' separate accounting argument then stated:

> We take a different view. We read the statute as calling for a method of allocation which is "fairly calculated" to assign to California that portion of the net income "reasonably attributable" to the business done there. The test, not here challenged, which has been reflected in prior decisions of this Court, is certainly not more exacting. *Bass, Ratcliff & Gretton, Ltd. v. Tax Commission*, 266 U.S. 271; *Ford Motor Co. v. Beauchamp*, 308 U.S. 331. *Hence, if the formula which was employed meets those standards, any constitutional question arising under the Fourteenth Amendment is at an end.*
>
> One who attacks a formula of apportionment carries a distinct burden of showing by "clear and cogent evidence" that it results in extraterritorial values being taxed. See *Norfolk & Western Ry. Co. v. North Carolina*, 297 U.S. 682, 688. This Court held in *Hans Rees' Sons v. North Carolina, supra*, p. 135, that the burden had been maintained on a showing by the taxpayer that *"in any aspect of the evidence"* its income attributable to North Carolina was *"out of all appropriate proportion to the business"* transacted by the taxpayer in that State. No such showing has been made here.
>
> It is true that appellant's separate accounting system for its San

Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121, that a State in attempting to place upon a business extending into several States "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Furthermore, the particular system used may not reveal the facts basic to the State's determination. Bass, Ratcliff & Gretton, Ltd. v. Tax Commission, supra*, p. 283. *In either aspect of the matter, the results of the accounting*

system employed by appellant do not impeach the validity or propriety of the formula which California has applied here.

At least since *Adams Express Co. v. Ohio*, 165 U.S. 194, this Court has recognized that unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis. As stated in *Hans Rees' Sons v. North Carolina, supra*, p. 133, ". . . the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." And see *Bass, Ratcliff & Gretton, Ltd. v. Tax Commission, supra*, p. 282. By the same token, California may properly treat appellant's business as a unitary one. Cf. *Great Atlantic & Pacific Tea Co. v. Grosjean*, 301 U.S. 412. (315 U.S. 506-508; emphasis added)

In *John Deere Plow Co. v. Franchise Tax Board, supra*, 38 Cal. 2d 214, 238 P.2d 569 (1951), appeal dismissed for want of a substantial federal question, 343 U.S. 939 (1952), the taxpayer again sought to rely on elaborate "separate accounting" data to invalidate the results of the California apportionment formula as applied to the unitary income of a unitary trade or business. California there noted that formulary apportionment:

. . . is not framed on the assumption that there must be uniformity of operating revenues and expenses in the relative functions of the various units contributing to the earnings of an integrated, multistate business and concluded that the attack on the formula by proof of the higher costs and the less profitable nature of the California business misconceives the whole purport of the unit rule of assessment, which rests on the principle that "where a business is unitary in character, so that its separate parts cannot be fairly considered by themselves and the whole business in the several states derives a value from the unity of use, allocation of income upon a reasonable formula is properly sustained." (38 Cal. 2d at 228, 238 P.2d at p. 577)

In regard to the taxpayer's reliance on "separate accounting" in *John Deere Plow Co.*, the California Supreme Court further noted:

> But in so arguing plaintiff fails to take into account the underlying concept of formula apportionment in the allocation of income from a unitary business: that the unitary income is derived from the functioning of the business as a whole, to which the activities in the various states contribute; and that by reason of such interrelated activities in the integrated overall enterprise, the business done within the state is not truly separate and distinct from the business done without the state so as reasonably to permit of a segregation of income under the separate accounting method rather than use of the formula method in assigning to the taxing state its fair share of taxable values. Butler Brothers v. McColgan, supra, 17 Cal.2d 664, 667-668, 111 P.2d 334; Edison California Stores v. McColgan, supra, 30 Cal.2d 472, 477-479, 183 P.2d 16; El Dorado Oil Works v. McColgan, supra, 34 Cal.2d 731, 735, 215 P.2d 4. . . . The fact that the taxpayer may show that according to a separate accounting system, the activities in the taxing state were less profitable than those without the state, or even resulted in a loss, does not preclude use of a formula as a method of apportionment of the unitary income. (Ibid.) The only requirement is that the formula used be not intrinsically arbitrary or produce an unreasonable result. Such was the situation in the case of Hans Rees' Sons v. State of North Carolina ex rel. Maxwell, 283 U.S. 123, 51 S.Ct. 385, 75 L.Ed. 879, where the court recognized the unitary character of the business as a manufacturing and selling enterprise extending into several states and to which a formula

method of apportionment was appropriate, but refused to approve the particular formula employed for the reason that it consisted simply of the property factor and failed to give proper weight to the extensive activities of the company without the state, so that the result reached was unreasonable. See Butler Brothers v. McColgan, supra, 17 Cal.2d 664, 673, 111 P.2d 334, Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48, 60, 156 P.2d 81.

Varying conditions in the different states wherein the integrated parts of the whole business function must be expected to cause individual deviation from the national average of the factors in the formula equation, and yet the mutual dependency of the interrelated activities in furtherance of the entire business sustains the apportionment process. North American Cement Corp. v. Graves, supra, 299 U.S. 517, 57 S.Ct. 311, 81 L.Ed. 381; Ford Motor Co. v. Beauchamp, 308 U.S. 331, 336, 60 S.Ct. 273, 84 L.Ed. 304. (238 P.2d 573-574)

Notwithstanding the unequivocal holdings in *Butler Bros., supra,* and *John Deere Plow Co., supra,* (dismissed by this Court on appeal for the lack of a substantial federal question), nevertheless Exxon, by reliance on *Hans Rees', supra,* and this Court's dictum in *Moorman Mfg. Co. v.*

Bair, supra, argues that its "separate accounting" controls disposition of this case. However, neither *Hans Rees'* nor *Moorman* turned upon "separate accounting." *Hans Rees'* turned on an unequivocal proffer of *conclusive evidence* (not "separate accounting") that the apportionment result arrived at by North Carolina's use of a single property factor apportionment formula was unrelated to instate income producing activities. In disposing of *Hans Rees'*, this Court held:

> For the present purpose, in determining the validity of the statutory method as applied to the appellant, it is not necessary to review the evidence in detail, or to determine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina. It is sufficient to say that, in any aspect of the evidence, and upon the assumption made by the state court with respect to the facts shown, the statutory method, as applied to appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. In this view, the taxes as laid were beyond the State's authority. *Shaffer v. Carter,* 252 U.S. 37, 52, 53, 57.

For this reason the judgment

> must be reversed and the cause remanded for further proceedings not inconsistent with this opinion. (283 U.S. 135-136)

In no sense can this case be held for authority that a taxpayer's "separate accounting" of its unitary income invalidates a three-factor apportionment formula applied to the unitary income of a unitary trade or business.

Nor is the dictum of this Court in *Moorman Mfg. Co. v. Bair, supra*, relating to "separate accounting" of any controlling significance. This Court's reference to the fact that Moorman failed to show what part of its profits was attributable to sales, to manufacturing or to any other phase of its operations by "separate accounting" (437 U.S. at 272) cannot be reasonably cited for the proposition that "separate accounting" can invalidate the reasonable apportionment of the unitary income of a unitary trade or business. The same is true in regard to this Court's reference to "separate accounting" in footnote 9 of the *Moorman* case. This Court there simply quoted from the statement of Justice McCormick in the Iowa Supreme Court *Moorman* opinion pertaining to the taxpayer's failure to utilize "sophisticated accounting techniques" to show that the Iowa single-factor apportionment formula produced an arbitrary result (437 U.S. 267 at 275). *Moorman* in no way overruled this Court's holding in *Butler Bros. v. McColgan, supra*, that "separate accounting" for the unitary income of a unitary trade or business can invalidate an otherwise reasonable apportionment of the entire net income of a unitary trade or business. In fact, in *Moorman* in commenting on a single-factor apportionment formula, this Court stated:

> In individual cases, it is true, the Court has found that the *application* of a single-factor formula to a particular taxpayer violated due process. See *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123; *Norfolk & Western R. Co. v. State Tax Comm'n, supra*. In *Hans Rees'*, for example, the Court concluded that proof that the formula produced a tax on 83% of the taxpayer's income when only 17% of that income actually had its source in the State would suffice to invalidate the assessment under the Due Process Clause. But in neither *Hans Rees'* nor *Norfolk & Western* did the Court depart from the basic principles that the States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportion to the business transacted . . . in that State," 283 U.S., at 135, or has "led to a grossly distorted result," 390 U.S., at 326. (437 U.S. 274)

Thus, the unitary principles which are applicable in determining the reasonableness of an apportionment result are dispositive of Exxon's due process of law "separate accounting" argument.

C. Exxon's "Separate Accounting" Does Not Establish That Wisconsin Has Attributed Income To Wisconsin Sources Unrelated To Exxon's Wisconsin Privileges, Activities An Income Sources.

Apart from its "separate accounting" argument, Exxon has not sought to establish that the well-recognized three-factor apportionment formula of Wisconsin has attributed income to Wisconsin not reasonably and rationally related to Exxon's substantial business activities in Wisconsin for the years in question.

Exxon's entire due process argument is based on the faulty premise that if "separate accounting" of its marketing activities attributes to Wisconsin an amount of "net income" substantially less than attributable to Wisconsin by Wisconsin's apportionment formula as applied to its marketing, refining and e & p activities combined, this proves that the apportionment result subjects "net income" unrelated to its Wisconsin activities, privileges and income sources to taxation. This argument of Exxon suffers from the same defects as Moorman's due process argument in the *Moorman* case, *supra*. In *Moorman*, Moorman could not show that even a single sales factor apportionment formula in fact apportioned to Iowa any "net income" Moorman would not have realized for the years there involved if it had not utilized Iowa for a market for approximately 20% of its products. Moorman simply argued that a three-factor formula would attribute less income to Iowa than the single sales-factor formula. Exxon is advancing the identical argument here by a comparison of its "separate accounting" for its marketing activities both within and without Wisconsin to the apportionment of its e & p, refining and marketing activities.

By apportionment of its marketing activities, separate from its e & p and refining activities, $2,086,607 "net income" was attributed to Wisconsin for the years in question (Exh. 28, A760). Apportionment of "net income" from all of its activities (primarily e & p, refining and marketing), attributed $4,532,155 "net income" to Wisconsin for the years in question (Exh. 28, A760). Thus, the "net income" in dispute in this appeal is $2,445,548, which Exxon claims was unconstitutionally taxed by Wisconsin. Since there was surplus crude oil on the American market and since Exxon had substantial excess refining capacity for the years in question, no one knows what Exxon's profits would have been from *any* of its operations but for its Wisconsin marketing activities. Exxon's "net income" from its e & p and refining operations may well have equalled substantially less than the differential here in dispute if it had conducted no marketing activities in Wisconsin for the years in question. This clearly demonstrates the hypothetical nature of Exxon's "separate accounting" argument. Furthermore, if for the years in question Exxon conducted no marketing activity whatsoever, which is the premise on which Exxon's "separate accounting" of its e & p and refining activities is premised, no one knows what "net income" Exxon would have realized from the balance of its operations. This alone dispells any notion that Wisconsin has measured Exxon's corporate privilege tax by any "net income" unrelated to its marketing activities in Wisconsin.

There are other basic fallacies in Exxon's "separate accounting" *per se* due process argument. Exxon's witnesses testified at length as to the reasonableness of it's "separate accounting" results. They explained in great detail how its e & p, refining and marketing *gross receipts* were reasonably related to market conditions. However, as heretofore indicated, their testimony further established

that the "separate accounting" results were a product of internal negotiations between e & p, refining and marketing, and hypothetical third-party dealings. That this "separate accounting" introduces some room for error, discretion and judgment can hardly be denied. This follows from the fact that its "separate accounting" was based on hypothetical transactions with third parties.

While these possible accounting discretions may be adequate for internal accounting controls and even for tax and royalty payments based on *gross receipts*, it takes little imagination to realize that "separate accounting" deductions can materially affect the attribution of *"net income"* among various segments of a vertically integrated business. This can be demonstrated by reference to Exxon's "federal taxable income" for the years in question as comparable to its total gross receipts. It can be further illustrated by the percentage of "accounting" error which represents the "net income" attributable to Wisconsin which is in dispute in this case.

For these years, Exxon's total receipts were approximately 27.183 billion dollars and its total federal taxable income was approximately 1.222 billion dollars, as declared on its federal income tax returns (Exh. 28, A760-A765). Federal taxable income represented approximately 4.5% of Appellant's gross receipts. If "separate accounting" were 95.5% accurate (20 to 1), such error could completely eliminate any federal taxable income for any of the Appellant's operating departments or more than assign the total income to any particular operating department.

For the years in question, approximately $308,371.00 of federal taxable income was assigned to the marketing function, $650,132 to the e & p function, and $233,754 to the refining function by "separate accounting" of the net income of these functions (Exh. 28, A760-A765). Given the fact that Exxon's gross receipts for the years in question amount to 27.183 billion dollars, it takes little imagination to see that a very small accounting error or discretion could substantially shift these profits.

The room for "separate accounting" discretion or error is more dramatically illustrated by reference to the "net income" which is in dispute here. The "net income" of $2,445,548, based on the average apportionment of .4429% of Exxon's "net income" to Wisconsin, represents only *.00899%* of the Appellant's 27.183 billion dollars of gross receipts for the years in question (Exh. 28, A766, A768, A770, A772). It represents approximately a 2% error in the assignment of Appellant's "net income" to marketing.

In addition, as heretofore indicated, while the Appellant's testimony centered on the "gross receipts" aspect of its "separate accounting," it produced no evidence either as to how its centralized administrative overhead, which exceeded one-third of its total gross receipts (presumably a large part of which is interfunctional transfers by the supply department) was allocated, apportioned or assigned to the various operating departments. This fact, coupled with the discretion and judgment involved as to the interfunctional assignment of "gross receipts" by internal accounting procedures plus the fact that we are here dealing with "net income" demonstrates the unreliability in this case of using Exxon's "separate accounting" as a constitutional due process standard.

D. Construction Of Wis. Stat. § 7.07(1) and (2) Which Requires The Inclusion In Apportionable Income Of Exxon's Income From Its Exploration And Production Operations Conforms To Both Due Process and Commerce Clause Restrictions On A State's Taxing Powers.

All of the unitary decisions referred to above in subdivision "B" of the Argument portion of this brief at pages 63-83 demonstrate that there is no merit to Exxon's argument that the inclusion of the income which it derives from its internal transfer of crude oil production in apportionable income for Wisconsin income tax purposes violates either the due process or commerce clause. This due process of law argument of Exxon is on no different constitutional footing than its argument that income from its refining properties or out-of-state marketing properties cannot be included in apportionable income. All of the unitary cases (property tax, franchise net worth, and income tax cases) discussed in subdivision "B" of this brief clearly indicate that out-of-state properties, values and income may be taken into consideration in the apportionment of a unitary tax base among the respective states in which the taxpayer conducts its business operations. The only due process requirement is that such properties or income or values constitute a part of the unitary trade or business of the taxpayer conducted in part in the taxing state.

Nor is there any merit to the multiple taxation commerce clause argument of Exxon. This Court has consistently held that if a tax is fairly apportioned to reach only that part of a tax base reasonably attributable to the taxing state, multiple taxation limitations of the commerce clause are satisfied. It has never invalidated a properly apportioned state tax on the grounds that it exposed interstate commerce to the *risk* of multiple taxation. In *Moorman Mfg. Co. v. Bair, supra*, this Court held that the prevention of any duplicate taxation would require uniform national rules for the division of income, both as to apportionment and specific allocation (separate accounting), which was not mandated by the commerce clause. It further held in *Moorman*, consistent with its holdings in *First Federal S & L Assoc. v. State Tax Commission*, 437 U.S. 255 (1975); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *General Motors v. Washington*, 377 U.S. 436 (1964); and *Standard Pressed Steel Co. v. Department of Rev. of Washington*, 419 U.S. 506 (1975), that in no event would it strike down a reasonably apportioned state tax by reference to speculative and unsubstantiated claims of duplicative taxation. As this Court stated in *Moorman*, after rejecting the proposition the commerce clause precluded any risk of duplicate taxation:

> Finally, it would be an exercise in formalism to declare Appellant's income tax assessments unconstitutional based on speculative concerns with multiple taxation. (437 U.S. 267 at 280)

In *Moorman*, in further response to alleged duplicate taxation there involved, this Court specifically found that:

> . . . *[T]his record* does not establish the essential factual predicate for a claim of duplicate taxation. (437 U.S. 267 at 276)

Again, in *First Federal S & L Assoc. v. State Tax Commission, supra,* this Court declined to invalidate a state tax based on claims that more than one state could tax the interest income of a savings and loan association as "wholly speculative and unsupported by evidence in the record." (437 U.S. 255 at 262)

Wisconsin has thus not transgressed due process or commerce clause limitations by including in apportionable income for Wisconsin corporate privilege tax purposes the income Exxon derived from its exploration and production operations, even though the properties to which such income was attributable by Exxon were located physically without the State of Wisconsin. This is particularly true when as here only the internal transfers of Exxon's crude oil is taken into consideration.

CONCLUSION

For the reasons developed in this brief, it is respectfully submitted that this Court should affirm the decision of the Wisconsin Supreme Court below. Exxon has the due process burden of establishing by clear and cogent evidence that the Wisconsin corporate privilege tax measured by "net income" has subjected any income, properties or values to tax which are not related to Exxon's Wisconsin activities and sources. It has failed to meet this burden. Exxon's "separate accounting" of its marketing profits in accordance with accepted accounting principles and in accordance with Exxon's internal management policies, fails to establish that Wisconsin has measured its corporate privilege tax by apportionable "net income" unrelated to Exxon's Wisconsin privileges, activities and income sources.

The fact that Exxon has not met this burden is supported by the following considerations:

1. Any reasonable interpretation and application of the facts in this cause clearly establish that Exxon conducted a vertically integrated unitary petroleum business by and through all of its operating departments for the years in question; and that it conducted a part of such business in the State of Wisconsin for the years in question.

2. Exxon made no profit until its products were sold to its marketing operations.

3. Since the "separate accounting" result relied upon by Exxon in this cause is a matter of Exxon's management policy determinations, obviously, Exxon has the ability to change the same at any time in its sole discretion and judgment. Therefore, the tax result it here contends for as a matter of due process of law is entirely within its control.

4. Exxon's "separate accounting" was dependent upon theoretical and hypothetical sales of its crude oil, natural gas and manufactured products to third parties. It was not based on any verifiable objective standard. Exxon's "separate accounting" results were dependent upon what transfer prices were determined appropriate by its supply department. The transfer prices were not the result of any independent determination, accounting or otherwise, by its various operating departments. Thus, centralized management and control determined any "separate accounting" results.

5. In ascertaining "net income," any slight shift in this "separate accounting" result materially affected the assignment of "net income" to the various operating departments of Exxon.

6. While Exxon sought to justify its "separate accounting attribution results by reference to "posted field

prices" for crude oil, "Fiske-type" formula for natural gas and "Platt's oil gram" for manufactured products, these references pertain only to assignment of gross receipts. *There is no evidence* as to the method used by Exxon to *assign* all of its *expenses* which were deducted to arrive at the separately accounted for "net income" of its operating departments. Furthermore, the evidence establishes that Exxon's reliance on "posted field prices," "Platt's oil gram" and "Fiske-type" formula were only used to *guess what Exxon might have received* in gross receipts from hypothetical transactions with third parties, which of course never took place.

7. The fact that Exxon relied solely on the conclusionary testimony of its expert witnesses and the hypothetical results of theoretical third party transactions at "arms' length" conclusively demonstrates the lack of any objective proof to substantiate the "separate accounting" of its "net income" to its various operating departments.

8. *But for* Exxon's marketing activities in Wisconsin, no one knows what Exxon's profits would have been for the years in question.

9. The foregoing considerations amply demonstrate the fact, as specifically found by this Court in *Butler Bros. v. McColgan, supra,* that "separate accounting" does not impeach the constitutional validity of the reasonable apportionment of the unitary income of a unitary trade or business. Furthermore, this Court's holding in *Hans Rees', supra,* and its dictum in *Moorman Mfg. Co., supra,* in no way conflicts with the holding of *Butler Bros.* that "separate accounting" is not of controlling significance here.

10. Exxon's "situs income argument" has no constitutional validity inasmuch as the states may take into account out-of-state properties, income and values associat-

ed with in-state properties and activities in determining the validity of an apportionment result within the purview of the due process clause of the United States Constitution. Here only production "net income" from innerfunctional transfers was included in apportionable income. Thus, only hypothetical production income has been included in apportionable income.

Respectfully submitted,

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Multistate Tax Commission

Counsel for Amicus Multistate Tax
Commission and Participating States

Supreme Court, U.S.
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MAR 11 1980
MICHAEL RODAK, JR., CLERK

No. 79-509

In the Supreme Court of the United States

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EXXON CORPORATION,

Appellant,

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Appellee.

On Appeal From the Supreme Court of Wisconsin

BRIEF OF APPELLANT IN RESPONSE TO BRIEFS OF MULTISTATE TAX COMMISSION AND STATES OF ILLINOIS, ET AL., FILED AS AMICI CURIAE

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INTRODUCTION

Briefs have been filed as Amici Curiae in opposition to Appellant's position by the Multistate Tax Commission ("MTC"), on motion granted without Appellant's consent, and by the States of Illinois, et al. ("Ill., et al.") with neither consent nor motion being required.*

---

* Frank M. Keesling has also filed an Amici Curiae brief pursuant to a motion allowed by this Court. Appellant's Objection To Motion Of Frank M. Keesling For Leave To File Brief Amici Curiae shall constitute Appellant's response to that brief.

This responding brief of Appellant is designed simply to identify in summary fashion, the legal and factual deficiencies and errors in these two Amici Curiae briefs. To avoid repetition, Appellant incorporates herein by reference the issues involved, the factual statements and the legal arguments and citations, all as set forth in the Brief of Appellant and the Reply Brief of Appellant filed with this Court in this case.

DEFICIENCIES AND ERRORS

The deficiencies and errors fall into three categories.

First, Amici Curiae, in effect, argue that expediency and convenience in the assessment of state income taxes and of taxes measured by income must prevail at all costs and that Appellant's position will impair such expediency and convenience. Under this contention, the issue of constitutionality is thrust aside by Amici Curiae.

Second, Amici Curiae have misconstrued the import of the decisions of this Court and of many other courts in an effort to avoid the constitutional issues being asserted by Appellant.

Third, Amici Curiae have injected matters not in the record in this case, have omitted consideration of or misconstrued certain important facets of the record, and have made speculative arguments inconsistent with the record.

ARGUMENT

The comments and observations of Appellant are set forth below under the three categories described above.

A. The Expediency and Convenience Proposition:

The theme of expediency and convenience is expounded and maintained throughout both Amici Curiae briefs. (MTC Br. pp. 2, 3, 4, 6, 43-44; Ill., et al. Br. pp. 1, 4, 5) The components of this expediency and convenience theme, as asserted by Amici Curiae, are (1) that, apparently for all practical purposes, all multistate corporations are automatically unitary, (2) that, therefore, the apportionment formula method of tax determination *must* prevail over any other method of tax accounting, including either geographic or separate functional accounting, and (3) that to permit separate functional accounting as employed by Appellant in this case would impair or destroy the convenience of apportionment to which Amici Curiae are dedicated. (MTC Br. pp. 3, 6, 38, 40-41, 44, 62-63, 67, 73-74, 88, 92; Ill., et al. Br. pp. 3, 4-5, 10, 11-12)

The compelled and only inference to be drawn from the foregoing is that expedience and convenience in the process of state tax assessments are, in and of themselves and without more, sufficient to withstand a constitutional challenge. This is not and never has been the law.

B. Misconstruction of Court Decisions:

In supplementation of the theme described in Subcaption A above, Amici Curiae advance a number of untenable legal propositions.

(1) By means of a rather subtle literary pattern, Amici Curiae seek to convey the impression that the terms "unitary" and "integral part of a unitary business", on the one hand, and "integrated" and "vertically integrated", on the other hand, are equivalent or synonymous terms and that, as a terminology group, they have achieved the statute of legal terms of art. (MTC Br. pp. 6, 7, 9, 10, 14, 30, 31, 36, 39, 42, 59, 61-63, 67, 91; Ill., et al. Br. pp. 9-10) This Court has never announced any such proposition, and the record in this case is to the contrary (A. 491-496).

(2) Amici Curiae, in a most persistent manner, seek to establish the proposition that the apportionment method of tax assessment has been legally sanctified as the *only* accepted method for the determination of taxable income. (MTC Br. pp. 7, 8, 39-40) To the contrary, this Court has only ruled that apportionment, as a reasonable approximation of taxable income, is legal if and when other methods fail to isolate and identify income derived within the taxing state. Appellant is not challenging those decisions.

(3) Amici Curiae first reach the argumentative plateau that all multistate businesses, or at least all vertically integrated corporations like Appellant, are unitary and, hence, apportionment is the only permissible method of assessment. They then arbitrarily reach the argumentative conclusion that situs income derived from Appellant's Exploration and Production function must be included in apportionable income, suggesting in this argumentative process that this is only a matter of state law and that Wisconsin was wrong in even excluding third-party sales at the well head. (MTC Br. pp. 9-10, 41, 44, 65, 92-93; Ill., et al. Br. pp. 4-5, 10) This Court has never ruled that either unitary or apportionment are *per se* concepts to be automatically applied to all income of multistate corporations, and, more importantly, this Court has never dealt with the issue of production situs income of multifunctional oil and gas companies, which is the principal issue in this case. (In Ill., et al. Br. p. 10, the decision of the Supreme Court of South Carolina in *Exxon Corp.* v. *South Carolina Tax Commission* is cited as an authority without noting that this case is on appeal to this Court on similar issues as are involved here.)

(4) It seems clear that Amici Curiae feel that the characterization of a taxpayer as being unitary is an essential condition precedent to the application of an apportionment formula, so, in their intensive effort to establish the unitary *per se* concept, they have indiscriminately cited a rather massive group of cases to which three important exceptions must be taken. (MTC Br. pp. 39, 40, 46-58, 60, 63-74, 77-80, 90; Ill., et al. Br. pp. 3-8, 11) First, certain decisions of this Court do appear to hold that unitary is a condition precedent to applying apportionment to total multistate income, but they do *not* hold that apportionment automatically follows unitary, much less do they support, or even deal with, the contention that oil and gas production situs income is subject to apportionment in either unitary or non-unitary situations. The basic issue has always been the proper isolation and identification of taxable income, not the superficial issue of unitary. Second, some of the cited cases touching on unitary deal with *ad valorem,* net worth and capital stock taxes where the issues are those of valuation, whereas the income tax cases involve the issues of isolation and identification. These two sets of issues are incompatible. Third, all the cited cases deal with transportation, communication, distribution, manufacturing and selling and similar operations; none deal with separate functional operations such as those of Appellant.

(5) Having asserted the erroneous proposition that unitary is synonymous with multistate operations from which follows the automatic apportionment of total income, Amici Curiae deftly assert three collateral propositions: (a) that the taxation test applies only to *realized* income as contrasted to *derived* income (MTC Br. pp. 42, 59, 91); (b) that "nexus" and "reasonable relationship" are satisfied if there is even a minimal state connection with only one of a taxpayer's separate functions, thereby entitling the state to reach total income (MTC Br. pp. 41, 65; Ill., et al. Br. p. 12); and (c) that in any event a state may tax a reasonable portion of total income (MTC Br. pp. 7, 8; Ill., et al. Br. pp. 3, 12). These propositions are not and never have been the law of state income taxation.

(6) Finally, it is asserted that the constitutional test of multiple taxation is that of the fact of multiple taxation rather than the risk of multiple taxation (MTC Br. pp. 45, 88-90). This is not the law. Moreover, even if it were, it is apparent from the record here and the cases cited in Appellant's Briefs that multiple taxation will result if the decision of the Wisconsin Supreme Court is not reversed.

C. Departures From The Record:

It is important to set the record straight as regards certain elements of the Amici Curiae briefs.

(1) With almost fanatical intensity, Amici Curiae attack all separate accounting, in general, and the separate functional accounting of Appellant, in particular, as being inappropriate for state income tax purposes, challenging in the process the validity and integrity of Appellant's separate functional tax accounting and its internal functional transfer prices on the speculative grounds that they

are or could be infested with errors, manipulation, arbitrary cost allocations, hypothetical transfer prices, etc., coupled with the assertion that, in any event, corporate financial accounting is not acceptable for tax accounting purposes. (MTC Br. pp. 4-7, 9, 15, 19, 25, 28, 29, 30-32, 35, 41-44, 63, 85-87, 90-92; Ill., et al. Br. pp. 6, 8) The very vigor of these arguments suggests their frailties. First, Amici Curiae choose to overlook the facts that the record here clearly shows: (a) that Appellant did not use corporate accounting in this case; (b) that Appellant's accounting in this case was tax accounting adjusted to the Wisconsin basis pursuant to Wisconsin law; (c) that Appellant's internal transfer prices were real, third-party equivalent prices, not hypothetical; and (d) that the validity and integrity of Appellant's separate functional accounting and internal transfer prices were never challenged, and, in fact, were practically conceded. Second, by such a glaring departure from the record in this case, it is patently clear that Amici Curiae are seeking to make new law by utterly condemning separate functional tax accounting in an effort to make the expediency and convenience of apportionment taxation the paramount, if not the only, method for state income taxation, ignoring in the process the law of this Court that apportionment is *permitted* only if isolation and identification of taxable income by other means fails.

(2) In a rather mystifying digression, Amici Curiae expound on the superior merits of a three-factor apportionment formula over a single-factor formula, with Appellant being charged with having taken the position that if the result from the use of separate functional accounting is less than that produced by the application of a three-factor formula, then the latter must automatically be wrong. (MTC Br. pp. 9, 65, 66, 82-84; Ill., et al. Br. p. 12) The

record, however, is eminently clear (a) that Appellant has raised no issue as to the relative merits between various types of apportionment formulae, (b) that Appellant has carefully and deliberately made clear that it is not challenging the propriety of using an *appropriate* apportionment formula under *appropriate* circumstances, and (c) that Appellant, having fulfilled the burden of both isolating and identifying Wisconsin taxable income, as well as isolating and identifying extraterritorial income, by separate functional tax accounting, merely compared those results with the Wisconsin apportionment results to demonstrate and quantify the extent of the Wisconsin overreach.

(3) In a complete and unwarranted departure from the record in this case, Amici Curiae dwell at length on data related to Senate hearings involving the petroleum industry. (MTC Br. pp. 32-35 and fn. 12 to p. 39, 62; Ill., et al. Br. pp. 8, 9) It is obvious on their face that this data involved legislative issues, concerns and considerations not relevant to the question of whether or not it is constitutional for Wisconsin to tax situs income earned from operations in other states, and the Wisconsin Circuit Court below summarily and properly rejected Appellee's effort to inject this data into the record in this case (JS App. 47-49), which ruling was not appealed to the Wisconsin Supreme Court.

CONCLUSION

For all the foregoing reasons, the briefs of Amici Curiae, MTC and Ill., et al., should be wholly disregarded by the Court in its consideration of the issues on appeal in this case.

Respectfully submitted,

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October Term, 1979
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vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin.

Motion for Leave to File Brief Amicus Curiae in Support of Appellee and Brief of Frank M. Keesling as Amicus Curiae in Support of Appellee.

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Motion for Leave to File Brief Amicus Curiae in Support of Appellee.

The undersigned, Frank M. Keesling, hereby respectfully moves for leave to file the attached Brief Amicus Curiae in this case. The consent of the Attorney General for the State of Wisconsin has been obtained. See Exhibit "A" attached hereto. In the belief that the Exxon Corporation is denying consent for the filing of any Amicus Curiae briefs, no effort has been made to obtain the consent of such corporation for the filing of the attached brief.

The undersigned has been interested in the problem of the allocation and apportionment of income for state tax purposes for nearly 50 years. As counsel to the California Franchise Tax Commissioner (the predecessor of the California Franchise Tax Board) during the years 1935-1939, the undersigned made

many contributions to the state's allocation and apportionment policies including the following:

1. Adopted a rule requiring the use of the three factor formula of property, payroll and sales in the apportionment of the income of a unitary business.

2. Made the administrative decision that the taxpayer in *Butler Bros. v. McColgan,* 17 Cal.2d 664 (1941), Aff'd 315 U.S. 501 (1942) was engaged in the conduct of a unitary business and that its California income should accordingly be determined by the formula method rather than by separate accounting.

3. Prepared the State's trial brief in the *Butler Brothers* case which served as the basic brief throughout the entire course of litigation and which set forth the reasons relied upon by the California Supreme Court in upholding the use of the formula method and which led this Court to affirm the California decision.

4. Instituted the combined return or combined report policy under which the income of a unitary business is apportioned by the formula method regardless of whether the business is conducted by one corporation with a number of branches or by a number of commonly owned corporations. This policy was upheld by the California Supreme Court in *Edison California Stores, Inc. v. McColgan,* 30 Cal.2d 472, 183 P.2d 16 (1947). It has since been adopted by some nine other states. It was upheld by the Supreme Court of Oregon in *Coca Cola Company v. Department of Revenue,* 271 Or. 517, 533 P.2d 788 (1975). The combined return policy has also been upheld by the Montana

Supreme Court in *Montana Department of Revenue v. American Smelting and Refining Company,* ..... Mont. ....., 567 P.2d 901 (1977). (Appeal to the Supreme Court dismissed for lack of jurisdiction, 434 U.S. 1042 (1978)). For a detailed discussion of the policy see Keesling, *A Current Look at the Combined Report and Uniformity in Allocation Practices,* 42 The Journal of Taxation 106 (February, 1975). (This article was based upon a talk given to the Multistate Tax Commission at its annual meeting in Denver, Colorado, 1974).

5. Extended to the state corporate income tax field the commercial domicile doctrine first announced by this Court in *Wheeling Steel Corporation v. Fox,* 298 U.S. 193 (1936). This extension was upheld in *Southern Pacific v. McColgan,* 68 Cal.App.2d 48, 156 P.2d 81 (1945). Since then, virtually all of the states which impose taxes on or measured by corporate income have adopted a similar policy.

In 1939, the undersigned entered private practice in Los Angeles, California, first as an associate and then as a partner of the firm of Loeb and Loeb. He is now, and has been for several years past, the Senior Attorney for that firm. Since entering private practice, he has engaged in the following activities with respect to problems similar to those involved in the instant case:

1. Represented a large number of corporations in connection with the allocation and apportionment of income for state tax purposes; such representation has included some of the larger and best known conglomerates in the country.

2. Appeared recently as an expert witness in the following state tax cases:

(a) *General Motors Corporation v. The State of Colorado,* 181 Colo. 360, 509 P.2d 1260 (1973). (Witness for the State); (b) *Kennecott Copper Corporation v. State Tax Commission of Utah,* 27 U.2d 119, 493 P.2d 632, Appeal dismissed 409 U.S. 973 (1972). (Witness for the Taxpayer); (c) The instant case when it was before the Wisconsin Tax Commission (Witness for the State); (d) *Multistate Tax Commission v. International Harvester, Inc.,* No. 1-76-182 (D. Idaho, Nov. 13, 1979), regarding whether the United States Steel Corporation should be held in contempt of the orders and rulings of that Court. (Witness for the Commission).

3. As co-author, contributed a number of chapters to a treatise discussing the allocation and apportionment of income. See Altman and Keesling *Allocation of Income in State Taxation* (1946) (2d Ed. 1950). One of the chapters so contributed was Chapter 5 in both editions entitled "Principles of Allocation of Business Income". This chapter discusses in some detail the identical problem involved in this case, *i.e.,* whether separate accounting or the formula method should be employed in determining the income attributable to a state from a business conducted both within and without the state. Based upon the reasons set forth therein, the conclusion was expressed that the formula method should be employed in the case of a unitary business. This chapter also articulates for the first time what has come to be known as the dependency or contribution definition of

a unitary business (both editions, p. 101). Subsequently, this definition was employed by the California Supreme Court in the *Edison Stores* case, 30 Cal.2d 472, 478. From there, this definition has spread all over the country and has been cited extensively in texts, law review articles, briefs and in opinions of appellate courts including the Supreme Courts of numerous states.

4. Author or co-author of various law review articles dealing with the allocation and apportionment of income, some of which are cited in the state court's opinion in the instant case and others in the appellant's brief. The subject of separate accounting versus formula is also discussed to some extent in the article relating to the combined return referred to above. 42 The Journal of Taxation 109, 110 (February 1975).

FRANK M. KEESLING,
Amicus Curiae.

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BRIEF OF AMICUS CURIAE ON THE MERITS IN SUPPORT OF APPELLEE.

Interest of Amicus Curiae.

Amicus Curiae is not representing anyone in this matter. As stated in the Motion for Leave to file this brief, he was a witness for the State of Wisconsin in the instant case when it was before the Wisconsin Tax Commission. Based upon his experience and presumed knowledge of the matter, he testified that the business conducted by the appellant's predecessor was unitary and that the formula method was properly applied to determine the income derived from marketing activities in Wisconsin. He is still of the same opinion for the reasons, among others, set forth herein.

This brief does not constitute a comprehensive discussion of the law relating to the apportionment of income for state tax purposes. Rather, it consists of a number of comments on various points which may be of some assistance to the Court in resolving the issues presented.

ARGUMENT.

I.

The Separate Accounting Method Should Not Be Employed to Apportion the Income of a Unitary Business.

A. Computation of Income of Separate Business.

As the California Supreme Court held in *Butler Bros. v. McColgan*, 17 Cal. 2d 664, 678 (1941), Aff'd 315 U.S. 501 (1942), if a business conducted within a state is separate and distinct from the business conducted outside the state, the separate accounting method may appropriately be used to determine the income from the business conducted within the state. In such a case, the income is computed in much the same manner as it would be computed in the case of a single business operated by a taxpayer entirely in one state. The first step is to compute the gross receipts of the business. The second step is to compute the cost of goods sold. By subtracting the latter amount from the gross receipts, the gross income of the business may then be determined. The net income of the business can be determined by subtracting the selling expenses and various overhead expenses from gross income.

B. Deficiencies of Separate Accounting in Apportioning the Income of a Unitary Business.

Where, however, the business conducted in the state is an integral portion of a business carried on both within and without the state, the separate accounting method should not be employed to compute the income attributable to the portion of the business within the state. *Edison California Stores, Inc., v. McColgan*, 30 Cal.2d 472, 478, 183 P.2d 16, 20 (1947); *John Deere Plow Co. of Moline v. Franchise Tax Board*, 38 Cal.

2d 214, 238 P.2d 569 (1951). To employ separate accounting to apportion the income of a unitary business is just as wrong as it would be to use a formula method to apportion the income of two or more separate businesses. *Caterpillar Tractor Co. v. Lenckos*, 77 Ill. App.3d 90, 395 N.E. 2d 1167 (1979), currently on appeal to the Illinois Supreme Court. It is like putting a square peg in a round hole or a round peg in a square hole.

There are several specific reasons why the separate accounting method should not be applied to apportion the income of a unitary business.

1. Impossible To Determine Income Specifically. First of all, the use of the separate accounting method in the case of a unitary business constitutes an attempt by mathematical computations to divide the indivisible. This point was clearly recognized by this Court in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920). The company was engaged in the manufacture of typewriters and accessory products in Connecticut and the sale thereof, partly in Connecticut but mostly in other states. It computed its income attributable to Connecticut by separate accounting. Based upon this method it concluded that all of its income was attributable to sales and none to the manufacturing operations in Connecticut. This Court, in an opinion by Mr. Justice Brandeis, made the following statement with respect to the separate or specific computation of the income of a unitary business:

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in

the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." 254 U.S. 113, 120-121.

2. Receipts Not Specifically Allocable. It is impossible to make the computations required by the separate accounting method. The first step is to compute the gross receipts attributable to the business in the state. If such business is truly separate and distinct, this computation can be made fairly easily and accurately. Where, however, the operations in the state constitute an integral portion of a unitary business conducted in part outside the state as well, there are no separate receipts attributable to any state. Instead, the receipts, although collected in a particular state, are the common product of a series of transactions, many of which take place in other states.

3. Expenses Not Specifically Allocable. Similarly, it is impossible to compute the expenses attributable to the earning of income in the taxing state. From the fact that certain expenses are incurred there, it does not follow that they were all attributable to the earning of income there. Instead, they contribute to the earning of income in all the states where the business is conducted. This point regarding expenses is well illustrated by *Butler Bros. v. McColgan*, 17 Cal.2d 664, 678 (1941), Aff'd 315 U.S. 501 (1942). The company operated seven wholesale department stores in as many states, one of which was in California. Its head office was located in Chicago, Illinois. Most of the goods for these stores were purchased centrally.

The company computed its California income by a separate accounting computation similar to that offered by the appellant in the instant case. Although the business as a whole realized a substantial profit, the company contended, based upon its separate accounting computations, that it sustained losses in California.

By buying in large quantities, it was able to obtain a purchasing profit *i.e.*, it obtained its goods for all of its stores at a price less than what otherwise would have been possible. It was able to buy in large quantities only because it sold in large quantities. Therefore, there was a direct unitary relationship between purchases and sales. California contributed some of the sales. Thus, the operation of the California store made contributions to the earning of the income of the business as a whole by helping to obtain lower prices for the goods sold in all the stores. The expenses incurred in California benefitted the entire business and should have been so charged as the Court in effect held by upholding the formula method which apportions the entire income considered as a single unit.

The relationship between sales and the ability of a corporation to realize profits through the reduction of costs is even more apparent in the case of a company engaged in the production, manufacturing and marketing of goods, as in the case of appellant, than in the case of *Butler Brothers* which engaged in manufacturing operations only to a small extent. If a company produces or manufactures only a small quantity, the per unit cost may be prohibitive. If, however, a large volume is manufactured, the per unit cost may be reduced substantially, thereby contributing to

the earning of larger profits. But, as in *Butler Brothers,* a company may manufacture in large quantities only if it sells in large quantities.[1]

Large-scale selling may also make numerous other contributions to the functioning of a company's business as a whole. Thus, it may permit centralized purchasing of machinery, equipment and supplies, thereby realizing substantial savings. It may also permit large-scale research which may be of inestimable value to the successful operation and growth of the company. In the case of a company like Exxon's predecessor it may permit large-scale exploratory activities and the development of better methods of drilling, extracting and refining oil. Selling on a large scale may also, as noted in the opinion of the California Supreme Court in *Butler Brothers,* 17 Cal.2d 664, 669, permit the taxpayer to obtain the services of more experienced and abler managerial and other personnel than might otherwise be possible.

Thus for the same reasons as in *Butler Brothers,* a substantial portion of a company's overall income should be apportioned to the states where marketing activities take place. The separate accounting method, however, ignores the contributions made by sales and is thus highly deficient in this respect.

4. Use of Fictitious Sales. There is a fourth significant reason for rejecting the separate accounting method as applied to a unitary business. In keeping with the notion that the manufacturing division is separate from the selling division, the goods transferred from the manufacturing division to the selling division are con-

[1]For further discussion of this point see Altman and Keesling, *Allocation of Income in State Taxation* (1946), (2d Ed. 1950), p. 100 (both editions).

sidered "sold". The "price" at which the goods are so "sold" is considered to constitute the separate gross receipts of the manufacturing division. By subtracting the actual cost of goods sold and also various overhead expenses, figures purportedly constituting the separate "gross income" and separate "net income" of the manufacturing division are computed. In turn, the "price" at which the goods are "sold" to the selling division constitutes the cost of goods to that division for computing what purports to be the separate "gross income" and "net income" of that division.

The procedure described above is wholly fictitious. There are no sales and no income is realized upon the transfer of goods between divisions of the same taxpayer.

5. Manipulation of Terms of Inter-Divisional "Sales". Furthermore, the terms of putative sales between divisions, unlike actual sales at arms length to strangers, are under the control of the taxpayer and may be manipulated to suit its tax convenience.

If it is desired to attribute all or most of the income to the states where sales take place, this can be contrived by "selling" the goods to the sales division at cost, or at a very low markup. This was done in the *Underwood Typewriter* case with the result that $1,293,643.95 of the company's income was attributed to states other than Connecticut and only $42,942.18 was attributed to Connecticut where the manufacturing operations and the executive office of the company were located.

In the *Butler Brothers* case the goods centrally purchased or manufactured were likewise charged to the wholesale stores at cost. Although the company still reported a loss in California, the overall effect of this method was to attribute all of the company's

income to the stores where sales were made and none to Illinois, where the headquarters office of the company was located and where the purchases were made.

For a number of years after California adopted the Bank and Corporation Franchise Tax Act in 1929 the members of a well-known and profitable California industry avoided the franchise tax by a similar technique. They sold all of their products to out-of-state distributing subsidiaries at cost. As a result, the producing companies reported no California income. Instead, all of the income was realized by the distributing companies and, for the most part, escaped taxation. In 1936 Counsel to the California Franchise Tax Commissioner instituted the combined report policy to prevent this type of tax avoidance.[2]

The above technique is also commonly used to avoid Federal income taxes as well as the income taxes of states which do not employ the combined report policy. For example, Company A manufactures foreign language encyclopedias which are in great demand in various foreign countries. The business is highly profitable. It organizes Company B, a wholly-owned subsidiary, in the Bahamas (or in some other jurisdiction which either does not tax income or taxes it at very low rates). It organizes another wholly-owned subsidiary, C, which functions as a sales organization in various foreign countries. The goods manufactured by A are sold to B at cost or at a very small markup. B resells the goods to C at a very high markup.

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[2]See Keesling, *A Current Look at the Combined Report and Uniformity in Allocation Practices*, 42 Journal of Taxation 106 (February, 1975).

For an excellent, extensive discussion of California's allocation and apportionment policies see Boren, 18 U.C.L.A. Law Rev. 478 (February 1971).

As a result, most of the income escapes tax both here and abroad.

If, on the other hand, it is desired to attribute most or all of the income to the state where the manufacturing operations are located, this can be accomplished by "selling" the goods to the sales division at a high markup. This markup may be based on the markup commonly prevailing in the industry in the case of wholesale sales. Or perhaps the taxpayer itself makes some arms-length wholesale sales and uses the same markup for its inter-division "sales". This technique was used successfully in *Studebaker Corp. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68 (1926). The Studebaker Corporation was engaged in the manufacture of motor vehicles in Michigan. The business was highly profitable. It organized a number of subsidiary sales corporations to which it sold its motor vehicles at a price which would not permit the subsidiaries to realize a profit. One of the subsidiaries was located in New York. The New York Tax Commission in an effort to attribute to New York a fair share of the profits derived from the manufacture of motor vehicles in Michigan and the sale thereof in New York, attempted to require the filing of a consolidated return. The New York Court of Appeals, in an opinion by Justice Cardozo, held that a consolidated return could not be required since it was not specifically authorized by the New York tax law.

The same technique of arranging a sale of products by the manufacturing division to the sales division at a high markup is also used extensively and successfully to avoid federal income taxes as well as state income taxes in states which do not use the combined report policy. For example, a company which is engaged

in the sale of men's clothing organizes a manufacturing subsidiary in some foreign jurisdiction which does not impose an income tax. The manufactured goods are sold to the United States selling subsidiaries at a price sufficiently high to prevent them from realizing a profit. As a result the income escapes tax completely except in states like California and nine other states which require the filing of a combined report and thereby apportion some of the income to such states by the application of an apportionment formula.

6. Conjecture as to Amount of Profits if Business Had Been Conducted Differently. There is a sixth compelling reason why the separate accounting method should not be used to apportion the income of a unitary business. Use of this method to determine the income of different divisions is fundamentally based upon conjecture as to the amount of income each division would have realized if the business of the company had been conducted in a different manner.

Thus, in the instant case, the conclusion that the production division realized a certain amount of income is based upon the assumption that such an amount of income would have been realized if the company instead of refining all the oil it produced had instead sold all such oil at arm's length to other refineries.

Again, the conclusion as to the amount of income that the refining company realized is based upon an assumption as to the amount of income such division would have realized if, instead of using its own produced oil for refining purposes, it had instead purchased oil on the open market and on the further assumption that instead of marketing most of its refined products it had sold all of such products to independent marketing companies.

These assumptions are not only hypothetical and conjectural but also highly questionable. There are substantial reasons for believing that if the three divisions had been operated as separately-owned companies, the aggregate profits may have been far, far less than the amounts realized under the common management and control of appellant's predecessor. Certainly, the movement in this country has been toward larger and larger business establishments and greater and greater integration of operations. There are a great many conglomerates composed of several hundred corporations engaged in a wide variety of business activities which are welded together into what is essentially one business under common management and control. For the most part, they function very effectively and result in greater profits than would be realized if each of the various companies were to be operated separately.

Some of these advantages resulting from large scale operations under common ownership, management and control have previously been mentioned. There are many others, but there is no need to belabor the point.

In any event, the states are confronted with enough problems in apportioning the income of businesses as they are actually conducted, without also considering how the income should be apportioned if the businesses had been conducted differently!

7. Impossibility of Monitoring Terms of Inter-divisional Transfers. Even if there were some merit to the separate accounting method, it should be noted that as a practical matter the states simply do not have the personnel, either in numbers or experience, to police or monitor the terms of the vast number of inter-divisional transfers made by hundreds of thou-

sands of corporations in numerous states and countries and which involve a myraid of different kinds of products. Under the formula method inter-divisional transfers are not considered as sales and accordingly it is unnecessary to check the terms of such transfers. In this respect as well as others, the formula method is much simpler than the separate accounting method to administer.

C. Cases Cited Do Not Support Appellant.

Appellant cites a number of cases which upheld the use of separate accounting in the apportionment of the income of integrated oil companies (App. Br. 40-44). These cases belong to a bygone era. They were out of step at the time with the decisions of this Court and with those of most other states. The Supreme Court of Wisconsin as presently constituted is clearly no longer in accord with the views expressed in *Standard Oil Company v. Wisconsin Tax Commission*, 197 Wis. 630, 223 N.W. 85 (1929). It is highly questionable whether any of the other cases cited have any vitality today.

These cases were decided prior to the great swing, in the early 60's toward achieving uniformity among the states by the use of the formula method instead of separate accounting. Prior thereto, there was so much chaos and confusion in the allocation policies of the different states that numerous bills were introduced in Congress to require all the states to use the same method of apportionment.

It is significant to note that these bills did not require that the states use separate accounting. In view of the different methods of applying separate accounting, such a requirement would have resulted in no

uniformity at all. Instead, the bills provided that the states must use a formula method consisting of the two factors of property and payroll. Furthermore, these bills contemplated that the formula would apply to all of a corporation's income, non-business as well as business.

Although the proposed legislation requiring uniformity was defeated, the states, in an effort to prevent possible future legislation of a similar character, began putting their houses somewhat in order. Many of the states adopted the Uniform Division of Income For Tax Purposes Act drafted and sponsored by the National Conference of Commissioners on Uniform State Laws in 1957. For a discussion of this development see Keesling and Warren, *California's Uniform Division of Income For Tax Purposes Act*, 15 U.C.L.A. Law Rev. 156 (1967). It is of considerable significance to note that the uniform act provides that "all business income shall be apportioned to the state by the use of a formula consisting of the three factors of property, payroll and sales". *Id.* 167.

D. Specific Source of Income Not Established.

Appellant claims that unlike the taxpayers in *Butler Brothers* and *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978) it has supplied proof as to the source of its income (App. Br. 15, 25). It has done no such thing. All it has done is supply separate accounting computations based upon the use of various assumptions which may or may not be true. The same type of proof was furnished and found inadequate in both *Underwood* and *Butler Bros.*

Appellant seeks to distinguish the instant case from other cases in which separate accounting computations

of income have been rejected by calling its computations "separate functional accounting" *Id.* But whether separate accounting is called "separate functional accounting", "geographical separate accounting" (App. Br. 25) or plain "separate accounting" it is still separate accounting subject to all the deficiencies of that method when applied to a unitary business.

E. Superior Oil Co. v. Franchise Tax Board Is Directly Contrary to Appellant.

The case of *Superior Oil Co. v. Franchise Tax Board*, 60 Cal.2d 406, 34 Cal.Rptr. 545, (1963) deserves special consideration here. *Superior* was engaged in exploring for oil and the extraction of oil in numerous states including California. Its headquarters office was located in Los Angeles. Unlike appellant's predecessor, (and other major integrated oil companies), it was a non-integrated company. Thus, it did not refine the oil it produced nor did it sell refined products either at wholesale or retail. Instead, it sold all of its oil at the well-head at posted field prices. Furthermore, Superior successfully used separate accounting in most states other than California. In most of these states, this method indicated the company had sustained losses in such states. Nevertheless, in computing its California income it employed a formula consisting of the three factors of property, payroll and sales which attributed a substantial amount of income to its operations outside of California rather than losses as shown by its own tax returns based upon its own separate accounting computations.

The California Franchise Tax Board was of the opinion that the operations in California were sufficiently separate and distinct from those outside of the state as to permit a reasonably accurate determination of

the California income by the separate accounting method. This opinion was reinforced by the fact that there was but little operational interdependency between the wells in California and those in other states. It was also reinforced by the fact that the taxpayer's own computations indicated that it sustained losses outside of California.

The Franchise Tax Board accordingly prepared its own separate accounting computation in accordance with established methods of accounting in the oil industry. This computation indicated that the operations in other states sustained a loss of $7,000,000, a figure consistent with the taxpayer's computations and that the operations in California produced a profit of some $10,000,000. An additional assessment was made on this basis. Thus the state urged the use of separate accounting and the taxpayer urged the use of formula method, a reversal of the usual roles in cases involving formula versus separate accounting.

The California Supreme Court unanimously sustained the taxpayer. It held that notwithstanding the various elements of separateness, the taxpayer was engaged in one unitary business and that the formula method was properly employed.[3]

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[3]Amicus Curiae served as Special Counsel to the California Attorney General in connection with the Superior Oil Co. litigation. He shared the belief of the California Franchise Tax Board that Superior's operations in California were sufficiently separate from its operations in other states as to permit the use of separate accounting. He has since come to appreciate more fully the enormous importance of Management and the centralized performance of numerous functions such as financing, advertising, research, etc., in the successful operation of a business.

Since the decision in *Superior*, the California Franchise Tax Board has broadened its classification of businesses as unitary. The text of the Board's current regulation relating to this matter is attached hereto as Exhibit B.

The separate accounting computations in the *Superior* case, unlike those of Appellant's predecessor, did not involve fictitious sales between divisions and again unlike the computations of Appellant's predecessor did not speculate as to the amount of profit *Superior* would have earned if it had conducted its business differently from the way in which it was actually conducted. Instead they were based upon actual sales and actual receipts.

Unlike Superior, appellant's predecessor was engaged in the operation of a large integrated oil company which was far more unitary in character than the business operated by Superior. It follows accordingly that if the California Supreme Court was correct in upholding the formula method in *Superior,* then surely the Wisconsin Supreme Court correctly held that appellant's predecessor was engaged in the conduct of a unitary business and that the formula method was properly employed.

F. Hans Rees' Is Contrary to Appellant's Position.

Appellant relies heavily on *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931) in support of its position that separate accounting may be used in the instant case. *Hans Rees'* does not support its position but instead is directly contrary thereto.

In that case, North Carolina used a single factor formula of property to apportion the company's income from a business carried on within and without the state. That formula attributed more than 80 percent of the taxpayer's income to North Carolina. This Court did not hold that the manufacturing operations constituted a business separate and distinct from the selling operations. It did not hold that the separate accounting

method could properly be employed to compute the income earned in North Carolina. All that this Court held was that the particular formula employed attributed an amount of income to North Carolina out of all proportion to the business done there and failed to take into account the extensive sales operations in other states.

Exactly the same statement can and should be made with respect to the separate accounting method in the instant case, *i.e.*, it attributes to the states where the production and refining operations were carried on an amount of income out of all proportion to the business done there and does not take into account the extensive sales and marketing activities in other states including those in Wisconsin.

If North Carolina had employed a formula which gave weight to the selling activities, there is little doubt that this Court would have upheld it.[4]

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[4]See Altman and Keesling *Allocation of Income in State Taxation* (1946) (2d Ed. 1950), p. 100 (both editions), where the following statement regarding the Hans Rees' case is made:

> The case of Hans Rees' Sons, Inc. v. North Carolina is often cited for the proposition that the separate accounting method is preferable to the formula method even in the case of a unitary business. An examination of the opinion in the case, however, clearly shows that it does not support that proposition. The company involved was engaged in the manufacture and sale of leather goods. It maintained a factory in North Carolina but carried on extensive sales and purchasing activities outside the state. Income attributable to North Carolina was determined by assigning to that state that portion of the total income which the value of tangible property within the state bore to the total value of such property within and without the state. The formula resulted in allocating approximately 89 per cent of the corporation's entire income to North Carolina. The court refused to approve the result not on the grounds that a formula could not be used, but on the grounds that in the particular case, the particular formu-

(This footnote is continued on next page)

II.

Appellant's Predecessor Was Engaged in the Conduct of a Unitary Business.

There can be little doubt that the business operated by appellant's predecessor was unitary in character. That business consisted of a large integrated organization devoted to the making of profits. Such profits were realized as a result of a series of transactions including the exploration for oil, the drilling of wells, the extraction of oil, the transportation of the oil to refineries, and the marketing of the refined products in various states including Wisconsin. These transactions were connected together in much the same manner as the links in a chain. Without exploration and drilling and the extraction of oil, there would have been no oil to process. Without the refinery operations there would have been no refined products to market. Without the marketing operations, there would have been no profits. Whether or not greater profits might have been realized if the business had been conducted differently is irrelevant. The classification of a business as separate or unitary must be made on the basis of the manner in which it was actually conducted, not on a "might have been" basis.

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ia employed consisting simply of the property factor did not give proper weight to the extensive activities without the state and that, accordingly, the result reached was unreasonable. If other factors had been used, such as payroll and sales, which would have given weight to the extensive out-of-the-state activities, the formula would unquestionably have been upheld.

III.

Conclusion.

It is respectfully submitted that the marketing operations in Wisconsin constituted an integral part of a unitary business carried on by appellant's predecessor within and without Wisconsin and that the Wisconsin Supreme Court properly upheld the use of the formula method in computing the income earned in Wisconsin.

Respectfully submitted,

FRANK M. KEESLING,
LOEB AND LOEB,
Amicus Curiae.

EXHIBIT "A".

The State of Wisconsin
Department of Justice
Madison
53702

(Letterhead)

January 29, 1980

Frank M. Keesling, Esq.
One Wilshire Building
Los Angeles, California 90017

Re: *Exxon Corporation v. Wisconsin Department of Revenue,* No. 79-509

Dear Mr. Keesling:

I hereby give my consent on behalf of my client, the Wisconsin Department of Revenue, to your filing of a brief *amicus curiae* in the above matter.

I am very appreciative of your assistance.

Sincerely yours,
/s/ Gerald S. Wilcox
Gerald S. Wilcox
Assistant Attorney General

GSW:ls

EXHIBIT "B".

Title 18, Bank and Corporation Tax.

Reg. 25120. Definitions of Business and Nonbusiness Income.

(a) Business and Nonbusiness Income Defined. Section 25120(a) defines "business income" as income arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, the business income of the taxpayer is that portion of the taxpayer's entire net income which arises from the conduct of the taxpayer's trade or business operations. For purposes of administration of Sections 25120 to 25139, inclusive, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income under Sections 25120 to 25139, inclusive and the regulations thereunder.

Nonbusiness income means all income other than business income.

(b) Two or More Businesses. One corporate entity may have more than one "trade or business." In such cases, it is necessary to determine the business income attributable to each separate trade or business. The income of each business is then apportioned by an apportionment formula which takes into consideration the instate and outstate factors which relate to the business the income of which is being apportioned.

Example: The taxpayer is a conglomerate with three operating divisions. One division is engaged in manufacturing aerospace items for the federal

government. Another division is engaged in growing tobacco products. The third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this state as well as in other states. In this case, it is fair to conclude that the taxpayer is engaged in three separate "trades or businesses." Accordingly, the amount of business income attributable to the taxpayer's trade or business activities in this state is determined by applying an appropriate apportionment formula to the business income of each business.

The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts of each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the divisions under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business; and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

(1) Same type of business: A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

(2) Steps in a vertical process: A taxpayer is almost always engaged in a single trade or

business when its various divisions are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the taxpayer's executive offices.

(3) Strong centralized management: A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, and purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are involved in the day-to-day operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising and financing

(c) Business and Nonbusiness Income; Application of Definitions. The classification of income by the labels customarily given them, such as interest, dividends, rents, royalties, capital gains, is of no aid in determining whether that income is business or nonbusiness income. The gain or loss recognized on the

sale of property, for example, may be business income or nonbusiness income depending upon the relation to the taxpayer's trade or business.

The following are rules and examples for determining whether the particular type of income is business or nonbusiness income:

(1) Rents and royalties form real and tangible personal property: Rental income from real and tangible property constitutes business income when the rental of such property is a principal business activity of the taxpayer or the rental of the property is related to or incidental to the taxpayer's principal business activity.

Example (A): The taxpayer operates a multi-state car rental business. The income from car rentals is business income since such activity is the taxpayer's principal business.

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No. 79-509

In the Supreme Court of the United States

OCTOBER TERM, 1979

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

OBJECTION TO MOTION OF FRANK M. KEESLING FOR LEAVE TO FILE BRIEF AMICUS CURIAE

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Pursuant to Rule 42(3) of the Rules of the Supreme Court of the United States, Appellant files this objection to the motion of Frank M. Keesling for leave to file brief amicus curiae. This objection is based upon the following reasons:

1. No Consent Requested.

Movant neither requested nor received the consent of counsel for Appellant to submit a brief amicus curiae. Rule 42(3) makes a request for consent of the parties a condition precedent to the filing of such a motion.

> "When consent to the filing of a brief of an amicus curiae is refused by a party to the case, a motion for leave to file may timely be presented to the court. . . ."

Since no consent was requested of Appellant, as acknowledged in paragraph 1 of his motion (Movant's brief, p. 1), Movant has not satisfied this condition precedent.

2. Movant is Professionally Disqualified to Act in Any Capacity as a Lawyer in This Case Because He Appeared as a Witness for the Appellee.

As acknowledged in Movant's motion (brief, par. 2(c), p. 4) and his statement of interest (brief, p. 7), Mr. Keesling appeared as a witness for the Appellee, the Wisconsin Department of Revenue, in the trial of this case before the Wisconsin Tax Appeals Commission. Now, attempting to wear an additional hat as lawyer—amicus curiae, Movant seeks to augment and support his own testimony. See, *e.g.*, brief, pp. 7; 21, fn. 3; 24. And he cites his own testimony (brief, p. 7) and law review articles (brief, pp. 12, fn. 1; 14, fn. 2; 19; 23-24, fn. 4) as authority. Such a patently obvious bootstrap approach is not permissible, nor is it helped by Appellee's consent to the effort. See Exhibit A to Movant's brief.

It is so well recognized as to be axiomatic that a lawyer may not serve as both advocate and witness in the same cause, and this is expressly recognized in the American Bar Association's Code of Professional Responsibility, which has also been adopted by the Wisconsin Supreme Court.

See Canon 5, Disciplinary Rule 5-102, and Ethical Consideration 5-9. EC 5-9, printed in Martindale Hubbell Law Directory Vol. VII (1980), A.B.A. section p. 25M, states in part:

> "The roles of an advocate and of a witness are inconsistent; the function of an advocate is to advance or argue the cause of another, while that of a witness is to state facts objectively."

The fact that Movant appeared as a purported expert witness in no way changes the situation. Indeed, the situation is aggravated because Movant opines on various topics in his brief on which he was not questioned by Appellee's counsel nor cross-examined by counsel for Appellant.

3. Movant Does Not Have a Sufficient Interest in the Case.

This Court's rules do not set forth the requisite qualification a party must have in order to file an amicus curiae brief. Although Rule 42(3) does provide that in a motion for leave to file such a brief, the applicant must state the nature of his interest. Consent to the filing of an amicus curiae brief should only be given when the applicant has a concrete and substantial interest in the decision of the case. Mr. Keesling has shown no such interest and he even concedes, at page 7 of his motion and brief, that he "is not representing anyone in this matter." The only interest he has is that of supporting his own theses and concepts as a practicing lawyer, author and witness in the field of state taxation.

Mr. Keesling without a client has no real interest in the decision of this case, and he must be disqualified as an amicus curiae.

4. Movant's Qualifications to Voice Opinions in This Case Have Already Been Impeached.

While appearing as a witness in this case, Mr. Keesling, over objection based upon lack of proper factual foundation and lack of qualification to give expert testimony as an economist (A. 579, 591, 594), testified that the marketing operation of Humble (Appellant's predecessor) in Wisconsin was an integral part of a unitary business (A. 594-95). On cross examination he acknowledged having *no* credentials as an economist and he admitted having *no* specific contact with the operations of Humble Oil & Refining Company and its operations in Wisconsin (A. 596-97). He also admitted that he did not *even* know the brand name under which Humble marketed gasoline in Wisconsin during the years in issue (A. 597). Thus, his opinions were conclusively impeached as having no expert economist or factual foundation.

Despite this, Movant now is asking the Court to consider his views, both as witness and as advocate.

CONCLUSION

Based upon the foregoing reasons, Appellant submits that Movant cannot be viewed as a proper advocate in this matter, and respectfully requests that his motion for leave to file a brief amicus curiae be denied.

Respectfully submitted,

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MOTION FILED
APR 4 1980

No. 79-509

In the Supreme Court of the United States

OCTOBER TERM, 1979

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

MOTION FOR SPECIAL LEAVE TO FILE SUPPLEMENTAL BRIEF AND SUPPLEMENTAL BRIEF OF APPELLANT

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In the
Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-509

EXXON CORPORATION,

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Appellee.

On Appeal From the Supreme Court of Wisconsin

MOTION FOR SPECIAL LEAVE TO FILE SUPPLEMENTAL BRIEF

Pursuant to Rule 41(5) and (6) of the Rules of the United States Supreme Court, Exxon Corporation, Appellant, respectfully moves for special leave to file the accompanying supplemental brief in this case.

On March 19, 1980, after the filing of the Brief of Appellant, the Reply Brief of Appellant and oral argument before this Court (held on March 18, 1980), this Court handed

down its opinion in the case of *Mobil Oil Corporation* v. *Commissioner of Taxes of Vermont,* No. 78-1201, ... U.S. ..... (1980). That case concerns the taxation of income of a vertically integrated multistate petroleum company, like Appellant, by means of an apportionment formula. As such, the *Mobil* case is an intervening matter that Appellant was not able, heretofore, to comment upon for the benefit of this Court.

Appellant therefore respectfully requests this Court to grant its motion for special leave to file its supplemental brief thereby providing this Court with Appellant's observations regarding the *Mobil* decision.

Respectfully submitted,

.....

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In the Supreme Court of the United States

OCTOBER TERM, 1979

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EXXON CORPORATION,

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Appellee.

On Appeal From the Supreme Court of Wisconsin

SUPPLEMENTAL BRIEF OF APPELLANT

ARGUMENT

In supplementation of its previous briefs, Appellant submits this brief in support of its view that the decision of this Court in *Mobil Oil Corporation* v. *Commissioner of Taxes of Vermont,* ..... U.S. ..... (1980), 48 Law Week 4306, handed down on March 19, 1980, the day after oral argument in the above entitled case, is entirely consistent with Appellant's position in this case.

There are only two narrow similarities between the two cases. Factually, both Mobil and Appellant are *integrated* petroleum companies (not to be confused with the *unitary* concept, for which see below), conducting only marketing functions in the taxing states. Legally, both Mobil and Appellant challenge the right of a taxing state (but on utterly different grounds) to include certain income in the income base to which an apportionment formula may be applied in the determination of the tax due the state. Beyond this, there are wide and significant divergences between the two cases which are crucial to this Court's consideration of this case. These divergences can be enumerated in summary form.

1. It should be noted at the outset that the two cases arose under two dramatically different taxing statutes. In the *Mobil* case, the Vermont statute defines the taxable income base as total taxable federal income, to which an apportionment formula can be applied "so as to allocate to the state *a fair and equitable portion* of that income" (Emphasis supplied; 48 LW 4307, nn 3 and 4). There is no indication from this Court's decision that Mobil ever challenged the taxing concept embodied in the Vermont statute. In contrast, the Wisconsin statute in this case provides for the specific allocation of situs income to the situs state with apportionment then being employed only to determine income *derived* from business conducted and property located *within* Wisconsin. The Wisconsin Supreme Court circumvented these statutory provisions by summarily holding Appellant to be unitary so that, *per se,* the apportionment formula could be applied to substantially all of Appellant's income, including situs income earned in other states. One of the reasons ascribed by that court for this conclusion was that Wisconsin was entitled to tax its *fair share* of Appellant's total income, regardless

of where derived, to which Appellant has lodged a vigorous constitutional challenge (App. Br. pp. 17-44).

2. In *Mobil,* this Court makes the threshhold observation (48 LW 4308) that "appellant has disclaimed any dispute with the accuracy or fairness of Vermont's apportionment formula". In sharp contrast, Appellant in this case, while conceding as an abstract proposition that an *appropriate* apportionment formula when *appropriately* applied is constitutional, has vigorously contested the judicial deviations from the statutory formula provisions so as to permit the application of the Wisconsin formula to almost all of Appellant's income, including production situs income derived from operations outside Wisconsin (App. Br. pp. 30-49).

3. As a further important threshhold observation (48 LW 4308), this Court noted that in *Mobil* the appellant sought, *without more,* to exclude dividends from the income base just because they were dividends, thus leaving that assertion as the sole, narrow, naked issue to be determined. As expressed by this Court, its only inquiry in *Mobil* was:

> ". . . confined to the question whether there is something about the character of income earned from investments in affiliates and subsidiaries operating abroad that precludes, as a constitutional matter, state taxation of that income by the apportionment method." (48 LW 4308)

Here, no dividend issue is in any way involved: rather, Appellant by virtue of the unchallenged integrity of its *separate functional accounting* and transfer prices has isolated and identified Exploration and Production Department income derived solely in states other than Wisconsin from the development of natural resources, crude oil and gas in this case. Stated another way, Appellant here is not claim-

ing exclusion of production income simply because it carried the situs "label" (like the "dividend" label in *Mobil*), but because it has successfully and without challenge geographically identified and accurately measured that situs income as being non-Wisconsin income (App. Br. pp. 9-12).

4. As a third threshhold observation in *Mobil,* this Court concluded that, although Mobil did not concede it was unitary, no evidence had been offered by Mobil to counter the "legal conclusion" that it was unitary and that all the subsidiaries from which the dividends derived contributed to Mobil's enterprise (48 LW 4308). Here, again, there is no parallel between *Mobil* and this case. Appellant has conceded, as found as facts by the Tax Appeals Commission as the trial tribunal, that each of its separate functional operations may be unitary in nature, but has introduced conclusive and unchallenged proof that its total corporate operations are not unitary as a whole (App. Br. pp. 7-9). The Wisconsin Supreme Court, ignoring this evidence. simply concluded that Appellant was unitary *per se* as a matter of law and hence it followed, *per se,* that Wisconsin could include virtually all of Appellant's income in the tax base, a conclusion which Appellant has strenuously opposed before this Court. (See more below on the concept of "unitary".)

5. It is abundantly clear that this Court in *Mobil* has in no way modified, much less overruled, its previous decisions relied on by Appellant which held that, to grant constitutional validity to state income taxes, the "requisite nexus" must be established and the tax cannot be "out of all appropriate proportion to the business" transacted in the taxing state (48 LW 4309). This Court emphasizes, however, that Mobil failed with respect to these issues to fulfill its burden of proof on three counts. First, even

though its only operational function in Vermont was that of marketing, Mobil permitted the inclusion of all of its operating income in the tax base without protest. Second, Mobil made no attempt to prove that the tax was out of all proportion to the business it transacted in Vermont. And third, Mobil asserted that there was no nexus with respect to dividend income, simply because it was dividend income received at a commercial domicile in New York and without any proof of lack of nexus between Vermont and the earnings from which such dividends were paid. Thus, Mobil permitted the apportionment of all of its operating income without challenge to nexus and yet challenged the inclusion of dividend income only because it was dividend income without proof of, or challenge to, the absence of the required constitutional nexus. As noted above, there is no dividend issue in this case, but, in terms of operational income, it should be indisputably clear from the record that Appellant, unlike Mobil, has fulfilled its burden of proof (a) that the only Wisconsin nexus is with Appellant's marketing function, which does not thereby entitle Wisconsin to reach for more than its proportionate tax on income from that function alone, and (b) that, by any conceivable measurement, the Wisconsin tax predicated on substantially all of Appellant's functional operations income was out of all appropriate proportion to the marketing business conducted by Appellant in Wisconsin thus bearing no fair relationship to the services provided by the State (App. Br. pp. 17-30).

6. As observed in paragraph 5 above, this Court in *Mobil* has not deviated from its prior decisions relied on by Appellant here as regards the "nexus" and "appropriate proportion" issues, to which should be added that, likewise, this Court in *Mobil* has not deviated from its prior decisions relied on by Appellant as regards the rela-

tionship between the unitary concept and the right of a state to invoke total apportionment (48 LW 4309-4310). The Due Process Clause requirement of a rational relationship between the activity being taxed and the taxing state thus remains as a fundamental principle. While alluding to various factual tests without indicating which test is specifically determinative for the conclusion of unitary, this Court did make it clear once more in *Mobil* that "the linchpin of apportionability in the field of state income taxation is the unitary business principle," *but* that this did not automatically authorize total apportionment if the taxpayer could fulfill the burden of proving that some portion of its income "was earned in the course of activities unrelated to the sale of petroleum products in that State." Appellant in this case clearly noted that unitary was a condition precedent (the "linchpin") to total apportionment and acknowledged that, whether or not it was deemed to be unitary, in order to attack the application of the Wisconsin apportionment formula it had the burden of identifying and isolating income unrelated to its marketing operations in Wisconsin (App. Br. pp. 25-28). It is not clear from *Mobil* whether or not the appellant there recognized these well established principles, but, nevertheless, the responses to them as between Mobil and Appellant stand in stark contrast:

A. The *Mobil* decison was predicated on the proposition that Mobil conceded it was unitary, whereas Appellant established the fact, as found at the trial tribunal level, that, at the very most, only each of its functional operations was unitary.

B. In terms of burden of proof, Mobil endeavored to support unconstitutionality on the grounds (1) that dividends, as such and without more, automatically provided exemption, (2) that receipt of dividends was

a separate taxable event which presumably isolated those dividends from apportionment, and (3) that the management of this dividend income was to be regarded as a separate enterprise free from apportionment. Nothing remotely resembling this theoretical mode of "burden of proof" has been advanced here by Appellant, and it relies on no artificial concept such as commercial domicile.

C. This Court in *Mobil* treated Mobil's "proof" as being akin to *geographical* accounting and rejected it as being insufficient to fulfill the burden of proof as it had done in previous cases. Here, however, Appellant has employed *separate functional accounting* proof with respect to its situs production income from natural resources (a new issue before this Court), its refining income and its marketing income. The integrity of this proof was upheld by the trial tribunal and has never been challenged or appealed from by Appellee (App. Br. pp. 25-26).

In short, even if, *arguendo,* Appellant be deemed to be unitary as a corporate whole, it has fulfilled its permitted burden of proving that which is non-Wisconsin income, whereas Mobil failed completely in this regard.

7. All the foregoing comments are directed at the Due Process Clause issues in the *Mobil* case. Mobil also claimed a violation of the Commerce Clause based on the risk of multiple taxation. But here again, there are pronounced and readily discernible differences between the *Mobil* case and this case:

A. As with the Due Process issue, this Court in *Mobil* faced the Commerce Clause issue with the threshold observations that Mobil had conceded unitary and

had failed to prove lack of nexus or disproportionate taxation. Quite the contrary is true here (see above).

B. Because it was dealing with intangibles in *Mobil,* this Court refused to be drawn into the hypothetical situs problem of those intangibles as a means of determining the risk of multiple taxation. Here, the issue of multiple taxation involves income from the operation of tangible oil and gas wells, all having a geographical situs outside Wisconsin, and as to which no hypothesis is needed to establish the location and nontransitory nature of their situs (App. Br. p. 32).

C. While agreeing "that the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy" (48 LW 4311), this Court noted the lack of proof as to where the intangible income could properly be taxed, refusing to accept a "fictionalized situs" for the income in New York. Thus, this Court found that the risk of multiple taxation had not been established, but expressly did *not* abandon risk as the proper test for invoking the multiple taxation doctrine. In contrast to *Mobil,* the present record conclusively shows the risk by geographically locating and accurately measuring the tangible production income in the states of its situs origin.

D. Finally, as contrasted to the hypothetical problem inherent in the *Mobil* case, the line of cases cited by Appellant (App. Br. p. 45) makes crystal clear that these production situs states, not only have the power to tax oil and gas production income, but have, in fact, exercised that power. It follows irrevocably, therefore, that in this case the application of the Wisconsin apportionment formula to that production situs income does constitute multiple taxation as a violation of the Commerce Clause.

CONCLUSION

There can be no escape from the fact that this Court in *Mobil* has in no way deviated from the prescriptions regarding the relationship between state income tax apportionment and the Due Process and Commerce Clauses as set forth in: *Hans Rees' Sons* v. *North Carolina ex rel, Maxwell,* 283 U.S. 123 (1931); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271 (1924); *Butler Bros.* v. *McColgan,* 315 U.S. 501 (1942); *Moorman Mfg. Co.* v. *Bair,* 437 U.S. 267 (1978). Nor can there be any escape from the conclusion that Appellant here has met the standards imposed by all these cases in its assertion of the unconstitutional application of the Wisconsin apportionment formula, and if, in the light of *Mobil* as the latest in this series of decisions, Appellant's record here does not establish unconstitutional taxation then such proof is judicially impossible.

Respectfully submitted,

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Part 2

Ford Is Knocked Out Again; Yankees Trail by 10 Games

Streaking White Sox Rout A's, Boost Lead

Bo Belinsky Finally Wins

Heft Quits Mets

New York, N. Y.

Mets Batting

Rodgers' Single Wins for Angels

Los Angeles, Calif.

Koufax Starts Rally That Downs Astros

Houston, Tex.

Tires

From page 18, column 6

Braves

From page 18, column 6

2 Day Carp Shoot at Muskego Lake

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Now Foyt has won the coveted No. 1 starting position for the upcoming Indy 500, turning in the fastest official time ever recorded in the time trials — again with a tiger in the tank of his Sheraton-Thompson Special! Jimmy Clark of Scotland, also with a tiger in the tank of his Lotus-Ford, also broke the previous record to take the No. 2 spot.

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Draft Tests to Be Tough for Cheaters

Washington, D. C. — Students who will start taking the selective service system's college qualification test next week for 2-S deferments will be under tight security to prevent others from taking their places.

Security is so strict that Science Research Associates, Chicago, which will administer the examination under a million dollar contract from selective service, is sifting wastebaskets in its printing rooms to prevent test papers from being smuggled out.

The test will be given four times—May 11, May 21, June 3 and in late June.

Each of the 900,000 students who are expected to take the test first will be fingerprinted. The test administrators want to be sure that no one takes the test more than once and that students lacking confidence do not have substitutes take the test for them.

So far, 870,000 registrants, or fewer than half of the 1,864,203 students who held 2-S deferments at the beginning of February, have applied for the first three tests.

An official of the testing firm said that none of the four tests would contain the same questions.

"We put them together from a pool of pretested questions," he said, "but only about four or five of our 1,200 employes have seen the assembled tests."

When exam time comes, he said, the sealed tests will be sent by registered mail to the 1,200 test centers in colleges around the country.

Stretchers Take 4 Whales Back to Deep Water

St. Augustine, Fla.—AP—Four pilot whales were saved Wednesday by a stretcher team which rushed to the seashore and hoisted them from shallow water where they had beached themselves.

Dr. Richard R. Lindy said the whales had a built-in sonar system that functioned only in deep water. Lindy said the sonar stopped functioning when a whale entered shallow water. Whales then act as if they are about to die and beach themselves—as if to commit suicide, he said.

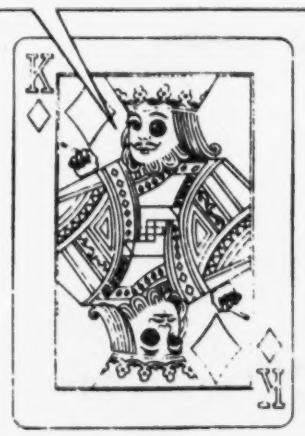
The whales — 1,000 pounds each and 8 to 10 feet long—were placed on stretchers, hoisted by hand onto trucks and taken to Marineland, six miles south of Crescent beach.

Lindy, head of neurosurgery at Albany (N. Y.) medical college, is doing research with medical students at Marineland.

—AP Wirephoto

Scottie De Turk, 2, inspected the heroism medal that Billy Haelle, 9, of Clifton Heights, Pa., received from the Boy Scouts. Billy, a Cub Scout, was honored for rescuing Scottie when he fell into a water filled pit last summer.

Us Tareyton smokers would rather fight than switch!



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Tareyton has a white outer tip ... and an inner section of charcoal. Together, they actually improve the flavor of Tareyton's fine tobaccos.

Monroe's Appeal Lowers Wages

Monroe, Wis. — Contractors for public buildings in Green county will have to pay only $2 an hour for general labor instead of $3.51, as a result of an agreement city and school officials reached Wednesday with the state industrial commission.

The industrial commission, which must by law set a wage schedule for public structures costing more than $5,000, had set the $3.51 hourly scale.

Mayor Walter R. Ekum and School Supt. Derwin J. Huenink argued at the meeting in Madison that the prevailing wage in Green county was only $1.50 an hour.

The officials said they regarded the $2 rate as a favorable compromise which could substantially reduce construction costs of a $400,000 municipal parking ramp and a proposed $856,000 grade school.

Future Astronauts May Need Germ Pills

Los Angeles, Calif. — Astronauts may have to eat bacteria rather than antibiotics to prevent dangerous infections that could plague them on long space journeys, says a medical authority.

If they don't, a possible consequence could be bacterial illness on the voyages or lethal "microbic shock" when they returned to the bacteria ridden earth after months of isolation, according to Dr. T. D. Luckey of the University of Missouri medical school.

It is conceivable that a wife's welcoming kiss could expose the astronaut to so many bacteria to which his body has lost immunity that it would literally be a kiss of death, Dr. Luckey said.

Tried on Guinea Pigs

He discussed the potential hazards of being isolated from bacteria for long periods during a symposium at the convention of the American Society for Microbiology.

The scientist said he based his speculations on studies with rats and guinea pigs that had been rid of all microbic life except possibly one species of yeast, one of mold and one of bacteria.

Bacteria that are harmless under normal circumstances when they are kept in balance by all other microbes can kill germ free animals within a week, Dr. Luckey said.

He said there was good reason to believe that the astronaut's sterile air, water and food would eventually, over several months' time, greatly reduce the varieties of bacteria present in his intestinal tract and on his skin.

Instead of carrying 200 to 500 species of microorganisms he might be reduced to several species.

No Sweat in Capsule

If the astronaut became ill as a consequence of the upset of the normal balance of intestinal bacteria, it might be better to take bacteria pills than antibiotics because the drug would only disrupt bacterial life more, Dr. Luckey said.

Another panelist, Dr. [illegible] Gall of International Business Machines in Bethesda, Md., reported a bit of good news. She said that studies of men in simulated space conditions who were not allowed to wash or change clothes for as long as six weeks showed an increase in the bacterial count on the skin, but there were no harmful effects seen—and surprisingly, no body odor.

Dr. Gall said this might be due to the nature of the specific

Women Endorse Liquor in Dorms

Houston, Tex. [illegible]

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Don't wait . . . this is a limited-time offer. Foreign Language Tiger Glasses are available exclusively at participating Enco dealers in this area. Drive in for your Tiger Glasses today. And while you're there, try a tankful of new High-energy Enco Extra gasoline . . . Put a Tiger in Your Tank! *Happy Motoring!*

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Tens midway through
quarter and raced
score and give the
Oilers a 10-6 victory
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rican Football league
Sunday.
un ran kicked field
18 and 31 yards for
but missed from 48
twice from 41 yards
team could generate
offense.

Clark Easy Winner in US Grand Prix

Watkins Glen, N. Y.

[illegible] place points will be available in the season finale, the grand prix of Mexico, Oct. 22.

Clark needed 40 laps of the 108 lap race to take the lead, then never relinquished it. He finished six seconds ahead of Lotus Ford teammate Graham Hill of England. Hill inherited second when the engine in Chris Amon's Ferrari failed on the 23rd lap. Only seven of the 18 starters finished.

Jo Siffert of Switzerland was fourth in Cooper Maserati, Jo Bonnier of Sweden was sixth in a Cooper Maserati, and Jean Pierre Beltoise of France was seventh in a Matra.

Dan Gurney, the only United States entrant, went out after 24 laps with suspension failure in his Eagle.

Foyt Nips Andretti, Boosts Point Lead

Sacramento, Calif. -AP- A. J. Foyt put more space between himself and Mario Andretti Sunday in their battle for the United States Auto club's national driving championship when he won the 100 mile dirt track race here.

Foyt nipped Andretti by six-tenths of a second, after having trailed from the second mile. He now has 3,040 points to 2,540 for second place Andretti. Foyt earned about $10,000 of the $30,000 purse.

The race on the mile track at the California State Fairground was run without a serious accident. George Snider finished third, ahead of Carl Williams and A. Unser.

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Foster, Regan Dodger Stars

Los Angeles, Calif. -

Clemente Wins, So Do Pirates

Pittsburgh, Pa. - Roberto Clemente won the fourth National league batting championship as the Pittsburgh Pirates defeated Houston here Sunday.

Clemente hit a home run and a triple to finish with a batting average of .357. I guess in the end it was Stan Musial and Willie Mays of Detroit for .301.

HOUSTON PITTSBURGH

Pinson and Reds Down Cubs, 10-3

Cincinnati, Ohio

Baltimore Wins but Finishes 6th

From Press Dispatches

Cleveland, Ohio – Marcelino Lopez and rookie Dave Leonhard held the Cleveland Indians to four hits here Sunday as the Baltimore Orioles won the season finale, 4-0, and finished in a tie for sixth place after winning the American league pennant last year.

BALTIMORE CLEVELAND

Yankees Down Kansas City, 4-3

From Press Dispatches

New York, N. Y. – The New York Yankees defeated Kansas City here Sunday, 4-3, on Joe Pepitone's two run homer in the eighth inning.

KANSAS CITY NEW YORK

McCormick Wins His 22nd, 2-1

From Press Dispatches

San Francisco, Calif. – Mike McCormick pitched five hit ball for his 22nd victory here Sunday as the San Francisco Giants beat the Philadelphia Phillies, 2-1, with a two run rally in the eighth inning.

PHILADELPHIA SAN FRANCISCO

Charles Wins Atlanta Open

From Press Dispatches

Atlanta, Ga. – Left handed Bob Charles, a former bank teller from Christchurch, New Zealand, shot a 70, two under par, Sunday to win the $115,000 Atlanta open golf tournament.

Charles finished with a 72 hole total of 282, two shots better than Tommy Bolt, Gardner Dickinson and Dick Crawford. Charles, rated the finest lefty in the game, picked up $22,000 for his victory and raised his 1967 winnings to $72,148, a record high for one year by any foreign golfer.

Charles, who won the British open and Houston classic in 1963 and the Tucson open in 1965, actually trailed Bolt by two strokes with 11 holes to play but two successive bogeys ended Bolt's hopes.

Cokes' Ring Title on Line Tonight

Oakland, Calif. –AP– Curtis Cokes will fight to eliminate any objection to his world welterweight boxing championship Monday night when he meets the Californian Charlie Shipes at the Oakland arena.

Cokes, of Dallas, Tex., won the World Boxing association crown by winning the tournament to determine a successor in the 147 pound division when Emile Griffith won the middleweight championship.

Because Shipes was bypassed in the tournament, the California athletic commission recognized him as world champion when he stopped Percy Manning of Philadelphia in the 10th round last December.

Despite the divided title claim, Cokes will collect more than three times the money Shipes will get. Shipes will get $11,000; Cokes a $42,500 guarantee. Henry Winston, promoting his first boxing match, figures a gate of $76,000 will be needed for him to break even.

Television plans were wiped out because of a strike against the American Broadcasting Co.

How They Fared

1. Notre Dame, 14, lost to Purdue, 28-21
2. Southern California, 20, beat Michigan State, 21-17
3. Houston, 34, beat Wake Forest 30-6
4. UCLA, 34, beat Washington State, 31-23
5. Georgia, 28, beat Clemson, 24-17
6. Colorado, 24, 6-6 and play
7. Nebraska, 28, beat Minnesota, 7-0
8. Texas, 0-2, lost to Texas Tech 19-17
9. Alabama, 14-1, beat Southern Mississippi, 28-3
10. Purdue, 28, beat Notre Dame 28-21

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Bowman Blasts Children's Code Changes

Madison, Wis. — [illegible] George Bowman of the Milwaukee county children's court Wednesday denounced proposed changes in the state's juvenile court law as "patently unworkable."

Bowman said the changes would increase the workloads [illegible] court and in the county sheriff's department.

Bowman cited Warren H. Evans, an assistant district attorney assigned to handle juvenile cases, who spoke against the proposed court system's code revision in one of the legislature's committee subcommittee. The committee is studying possible changes in the code to recommend to the 1969 legislature.

Eight other persons who attended the hearing favored the revisions, although some suggested changes.

[illegible] to a proposal to divide [illegible] delinquency hearings into two parts.

In the first part, the judge would hear only evidence pertaining to the act for which the youth was brought to court and would determine whether he committed it.

Both Parents Notified

In the second part, in which the judge would determine disposition of the case, he could consider background information about the child — home situation and prior record, for example. It would not be permitted at the first stage.

The two part hearing would create an impossible work load, Bowman claimed.

He and Evans also opposed a provision requiring that both parents of an accused delinquent, not just one, be served [illegible] court hearing. The requirement would place an undue burden on the sheriff's department, which serves the notices, they said.

State Sen. Norman Sussman (D-Milwaukee) said that juvenile court rules for Milwaukee county should be different from those of the rest of the state, to take into account Milwaukee's high case load.

Other speakers called the proposed revisions a step in the right direction.

County Judge James W. Byers, Green Bay, said the divided hearing need not cause delays. A judge could go immediately from the first part of the proceeding to the second, he said.

"The only change is that a judge can't look into the social history of the child before making a finding," Byers said.

Notification of both parents [illegible] "Except that [illegible] concern not for judges or for the staff shouldn't be the deciding factor," he said.

Other Support Given

Waukesha county Judge Harold J. Wollenzien said the two part hearing would be acceptable, but he agreed with Bowman that serving notice on both parents would be difficult.

Wisconsin Honors Slave Who Became Lawman

Portage, Wis. (UPI)— Thursday was Ansel Clark day in the state of Wisconsin.

Clark, a Negro who died Aug. 18, 1932, rose from slavery to become one of the city's most beloved and respected citizens.

During his more than 70 years in Portage, Clark served as deputy sheriff of Columbia county, town constable and county humane officer. He also was a member of the volunteer fire department and a member of the Wisconsin national guard.

In a proclamation, Gov. Knowles said, in part: "It is the policy of the state of Wisconsin that all our citizens shall have equal opportunities regardless of race, color, religion, national origin or ancestry in accord with our long held principle of liberty and justice for all."

Clark served on both sides of the Mason-Dixon line during the civil war. He was pressed into service as a laborer for the confederate army when war broke out. A few days later, he was captured by the union forces. After breaking out of prison and returning home, Clark joined the union forces.

After the battle at Vicksburg, Clark found his way here in 1867.

Clark was employed by the pioneer Wisconsin jurist, Judge John Clark, as a coachman and later by W. W. Corning, a leading merchant. It was in Corning's family plot that Ansel Clark's body was interred.

Picture on Picture Page

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